UNIVERSITY OF PENNSYLVANIA

STATE SUPERVISION OF MUNICIPAL INDEBTEDNESS

LANE LANCASTER

A THESIS

IN POLITICAL SCIENCE

PRESENTED TO THE FACULTY OF THE GRADUATE SCHOOL IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF DOCTOR OF PHILOSOPHY

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INTRODUCTION

The student of American municipal government during the last twenty years is struck by few facts so much as by the enthusiasm of citizens and officials alike for the physical improvement of our urban communities. The village governing board, with its plans for a little Broadway, the Commercial Clubs of provincial centers, with their dreams of ornate "civic centers," and the council of the metropolis, armed with blueprints and specifications for a far-reaching city plan—all are bidders in the money market for the wherewithal to transmute their imaginings into steel and concrete and asphalt. According to a recent report of the Boston City Planning Board, public improvements under way or completed in six of our ten largest cities involve expenditures totalling more than half a billion dollars.[1] Approximately 175 city planning commissions are at work in 33 states on projects for community betterment; and at least two states require such commissions in all cities of over ten thousand population.[2] Such mammoth projects as the Catskill Water Supply for New York City, the plans for the water supply of the Metropolitan District of northern New Jersey, the Chicago City Plan, and the Port Development of New York City have their counterparts on a smaller scale in every progressive American community.[3]

All these things cost money—money which must come ultimately from the pockets of local taxpayers. And the money must, in many cases, be furnished more rapidly than it can be obtained through the ordinary channels of taxation. The problem of debt administration, then, becomes one of prime importance. Indeed, if debt creation continues at the present

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[1] *8th Annual Report of the City Planning Board*, Boston, 1922, pp. 3–10.

[2] Information compiled by the National Conference on City Planning as of July 15, 1922. The two states referred to are Pennsylvania and Massachusetts.

[3] See *Report of the New York Department of Docks* for 1921; *New York Board of Water Supply* for 1920; *Report of Hazen, Whipple and Fuller: "Water Resources of the State and Their Development,"* published by the New Jersey Department of Conservation and Development, 1922; *Reports of the Chicago City Plan Commission* and the *Chicago Board of Local Improvements.*

rate, the future financial condition of our cities will depend largely upon the outcome of the race between local pride and efficient local financial administration.

The only tenable point of view of the student of municipal indebtedness is that our states are finally responsible for setting up and enforcing correct standards of administration. Our public law relegates municipal corporations to subordinate positions in our political system. It also places in our legislatures unlimited power to create additional corporations and quasi-corporations for a variety of special purposes, and to vest these with power to levy taxes and incur indebtedness. By no conceivable stretching of the doctrine of "home rule" can complete financial independence be claimed for such corporations. The serious nature of the problem is accentuated by the fact that most of the actual administration of local debts is in the hands of local governments, acting in law as state agents, but relying on the services of locally elected officials, often conspicuously lacking in experience and ability.

The relation of principal and agent existing here requires that the principal should (1) impose certain approved standards, and (2) create adequate machinery for enforcing compliance with such standards. In financial questions standards will, as a rule, be evolved by those whose business it is to deal with such questions. It is the duty of government to conduct its own purely financial affairs in accordance with such approved standards. The machinery of enforcement will in turn be influenced by the same factors which aid in creating these standards. It is the purpose of this study to discover the extent to which our state governments have adopted real policies toward local indebtedness and the degree to which such policies conform to the true nature of the problem.

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I

American Municipal Indebtedness

The Report of the Joint Legislative Committee to Investigate the Affairs of the City of New York, appointed in 1921, begins its discussion of the city's indebtedness with the striking statement that "the city has run in debt approximately one hundred thousand dollars a day since the Greater City was incorporated" (*i. e.*, 1901), and follows it with a recital of the shifts to which the city has resorted in its attempts to meet its mounting expenses without exceeding the constitutional debt and tax limits.[1] While it is perhaps not fair to consider New York's situation as typical, an examination of the public documents of widely separated portions of the country makes unavoidable the conclusion that in a large degree a similar state of affairs exists elsewhere. The investigation of the Special Joint Committee on Taxation and Retrenchment of the Legislature of the State of New York revealed that the net debt of local governmental units in that state increased nearly 74 per cent in the ten years from 1911 to 1920. The figures showing this increase are given in table I.

During the ten years covered by this table the population of the state increased but 14 per cent.[2]

In California, the State Controller in his Annual Report of the Financial Transactions of Municipalities and Counties for the year 1921 states that during the past decade "the total

[1] The statement follows: "The city has run in debt approximately a hundred thousand dollars a day since the Greater City was incorporated. The funded debt has fluctuated around the constitutional debt limit for ten years. The tax rate has risen until it has reached, if not passed the constitutional tax limit. All other means of raising funds having been exhausted, resort has been had to various devices including doubtful interpretations of constitutional limitations not contemplated at their enactment, to statutory relief unsound in principle if not unconstitutional, . . . to increasing and making permanent the floating debt, . . . and to the use for current expenses of the income of public utilities allocated in law and equitably applicable to the principal and interest of bonded indebtedness incurred in the construction of such utilities. These devices proving inadequate, the power of assessment has been resorted to by the city administration . . . until the assessment has reached approximately 94 per cent of the actual value, a rate much larger than the rest of the state. Like other devices this is nearly exhausted."

[2] *Report* (Legislative Document, No. 72, 1922), pp. 29, 33.

TABLE I.—LOCAL DEBTS AND ASSESSED VALUATION IN NEW YORK STATE 1911–1920 (000's OMITTED)

YEAR	NET DEBT	ASSESSED VALUATION	PER CENT INCREASE IN	
			DEBT	VALUATION
1911	$ 896,715	$10,121,277		
1912	972,445	11,022,985		
1913	1,043,890	11,128,498		
1914	1,126,710	11,385,137		
1915	1,211,399	12,070,420		
1916	1,250,590	11,790,628		
1917	1,256,137	12,091,437		
1918	1,332,492	12,520,819		
1919	1,321,592	12,758,021		
1920	1,559,795	12,989,433	73.9	28.3

bonded debt of all forms of government—state, county and municipal—has increased 242 per cent, while the wealth of the state has increased about 60 per cent." This increase amounts to about 3 per cent of the wealth of the state. The interest charge on these obligations for the year ending June 30, 1921, was $27,559,297, to raise which would require a levy of 56 cents on every hundred dollars of valuation. The municipal bonded debt alone in the period 1911–1921 increased from $65,573,033 to $149,611,830 or 128.3. The pertinent facts in this growth of municipal debt are set forth in the next table.[3]

TABLE II.—GROWTH IN ASSESSED VALUATION, POPULATION AND DEBT IN CALIFORNIA MUNICIPALITIES, 1911–1921 (000's OMITTED)

YEAR	ASSESSED VALUATION	PER CENT INCREASE	POPULATION	PER CENT INCREASE	DEBT	PER CENT INCREASE
1911	$1,640,991	....	1,625	....	$ 65,573	
1921	3,041,670	85.3	2,505	53.3	149,611	128.3

The Director of Finance of Idaho in his First Biennial Report asserted that "it is safe to say that the bonded debt of the counties and other political subdivisions has more than doubled in the last two years." In spite of what he regards as a potentially serious situation, the people of the state at the election

[3] *Report* for 1921, p. 10. Population figures are from the Census Reports of 1910 and 1920 and include urban population only. Property is assessed at about 48 per cent full value.

of 1920 voted to raise the constitutional debt limit. The director was sufficiently impressed with the dangerous possibilities of the situation to recommend that some "central supervision be provided of proposed bond issues by the political subdivisions of the state."[4]

The Auditor of Public Accounts of Nebraska in his report for the biennium ending November 30, 1920, states that during the two years covered by the report bonds of the political subdivisions of the state to the face value of $22,124,089 had been registered in his office. This was almost exactly three times the amount registered during the biennium immediately preceding and constitutes more than 40 per cent of all Nebraska "municipals" outstanding at the time of the Auditor's report.[5]

A still more serious situation is revealed by figures on the public debt of Ohio municipalities during the past few years. The table below compiled from the reports of the Auditor of State indicates the growth of public debt in the subdivisions of that state for the years 1890 to 1921.

TABLE III.—INDEBTEDNESS OF OHIO COUNTIES, CITIES AND SCHOOL DISTRICTS, 1890–1921 (000's OMITTED)[6]

YEAR	COUNTIES	SCHOOL DISTRICTS	CITIES	TOTAL
1890	$ 6,974	$ 3,103	$ 52,963	$ 62,992
1900	10,521	7,153	77,299	96,193
1910	26,979	16,949	147,174	187,574
1915	56,074	48,707	223,293	356,928
1920	77,096	100,152	288,969	510,266
1921	889,261	133,029	342,112	607,922

From 1910 to 1920 the population of the state increased 21 per cent, its taxation 117 per cent and its total public debt 172 per cent.[7] The increase in debt during this ten-year period amounted to $322,000,000, a sum twice as great as the increase recorded for the whole of the nineteenth century. This piling

[4] *Report*, pp. 20, 21, 24–25.

[5] *Report*, pp. 9, 136–159.

[6] *Report of the Auditor of State*, 1921, pp. 179–195. Years ending June 30th. Complete data on the growth in local debts may be found in the reports for 1919, 1920 and 1921.

[7] Until the issue of Soldiers' Bonus bonds in the sum of $25,000,000 in 1921, the state government of Ohio had no bonded debt.

up of debt went on apace during the year 1921, figures for that year indicating that a net increase of $121,262,337 was made. The distribution of this increase is shown in the table following.

TABLE IV.—NEW DEBTS CREATED VS. OLD DEBTS PAID—OHIO CITIES, VILLAGES, COUNTIES AND SCHOOL DISTRICTS, 1921[8]

	PAID	CREATED	NET INCREASE
City debts	$15,739,668	$ 62,485,950	$ 46,746,282
County debts	9,696,369	21,169,640	11,473,271
Village debts	3,479,914	6,649,589	4,169,675
School district	10,565,709	69,438,818	58,873,109
Total	$39,481,660	$160,743,997	$121,262,337

This increase was at the rate of approximately 20 per cent or $16.95 per capita; the increase in the taxable wealth of the state was at the rate of 10.6 per cent.

Since 1910 Ohio cities have operated under the so-called Smith One Per Cent Law[9] the practical effect of which has been to limit the tax rate for all purposes, including sinking-fund charges, to 15 mills on the dollar of assessed valuation. Although amendments to the original limitation were frequently made the effect of the law in many cities was to restrict unduly their tax-levying powers. In many cases cities were driven to the creation of bonded debt for supplying current needs and sinking funds were depleted by their taking advantage of a law which allowed such funds to be used to pay judgments against the city—judgments often secured in recent years by the collusion of the city and its creditors.[10] Under these conditions increases in debt meant, obviously, that a growing portion of the revenue must flow into sinking funds. The table which follows shows the portion of current revenues required to keep sinking funds up to standard requirements in the various taxing districts of the state.

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[8] *Report of the Auditor of State*, 1921, pp. 5, 190–193.

[9] *101 O. L. 430; 102 O. L. 552; 104 O. L. 12.* The history of the Smith Law is discussed in Clair Wilcox, *Rate Limitation and the General Property Tax in Ohio* (Ohio State University, M. A. Thesis, 1922), pp. 39–47.

[10] For instances, see Wilcox, *op. cit.*, pp. 49–50.

TABLE V.—PER CENT OF TOTAL LEVY OF TAXES FOR CITY PURPOSES REQUIRED FOR SINKING FUNDS IN EIGHTY OHIO CITIES, 1919 AND 1920

PERCENTAGES	NUMBER OF CITIES	
	1919	1920
1 to 10	..	2
11 to 20	3	2
21 to 30	8	7
31 to 40	17	13
41 to 50	16	15
51 to 60	21	23
61 to 70	7	12
71 to 80	5	5
81 to 90	..	1

This table shows that in 1920, of the eighty cities reporting, forty-one were paying more than half of all revenue collected into sinking funds and only eleven were paying less than 30 per cent, which figure may be reasonably considered a safe upper limit for such charges. A similar table compiled for forty-eight village governments shows that two-thirds of the villages were paying more than 50 per cent of their revenue into sinking funds. School districts make a better showing, but this is largely due to the fact that they are normally in receipt of large subsidies from the state treasury.[11]

The situation in the various taxing units had become so serious in 1920 as to lead to concerted action on the part of organized agricultural and commercial interests looking toward the stricter regulation of local debt and taxing powers. This resulted in the passage, by the 1921 session of the General Assembly, of the so-called Griswold Law, designed to place local financing on a scientific basis.[12] In spite of the excellent features of this law, the fact remains that Ohio local governments are laboring under a weight of indebtedness which will prove burdensome in the extreme until tremendous increases have taken place in the taxable wealth of the state.

[11] This table was compiled from figures furnished by the Ohio Legislative Reference Department and the Ohio Institute of Public Efficiency.

[12] *109 O. L. 336–351.* This law is discussed briefly in Chapter V.

The United States Census Bureau supplies us with some interesting figures on the growth of public debt in cities having a population in excess of 30,000. In 146 cities for which comparable figures exist since 1903 the increase in per capita interest payments since that date is shown in the table which follows.

TABLE VI.—PER CAPITA NET DEBT AND INTEREST PAYMENTS IN 146 CITIES OF MORE THAN 30,000 POPULATION, ALTERNATE YEARS, 1903–1919

YEAR	PER CAPITA		PER CENT INTEREST PAYMENTS OF TOTAL PAYMENTS	PER CENT INCREASE IN PER CAPITA INTEREST PAYMENTS
	NET DEBT	INTEREST PAYMENTS		
1903	$53.08	$2.06	8.3	
1905	50.66	2.36	9.2	
1907	55.42	2.55	8.6	
1909	60.63	2.84	9.4	
1911	65.84	3.01	9.4	
1913	67.57	3.10	9.7	
1915	75.56	3.51	10.3	
1917	77.78	3.57	11.0	
1919	77.82	3.77	10.9	83.0

The figures furnished by the Census Bureau are defective for our purposes in that they report conditions in only 146 urban communities. There are in the United States scores of thousands of subordinate corporations vested with tax-levying and debt-incurring powers and reliable data concerning the financial affairs of these are available in the Census Bureau publications only once in ten years. The table above, however, does indicate a huge increase in the interest burden in the cities represented and has perhaps more significance than would appear at first sight inasmuch as the cities covered are the larger ones where the character of administration is, on the whole, higher than in smaller communities.

Special studies made in individual cities within the past few months reveal further interesting facts concerning the growing debt burden. A survey published in June, 1922, by the Cleveland Municipal Research Bureau showed that for the current year debt charges in that city required 32 cents out of every dollar of taxes; moreover, it was hinted that to keep the sinking

funds up to actuarial requirements would require an additional annual levy of approximately $200,000.[13] The St. Paul Bureau of Municipal Research published in 1922 a study which showed that, with a deficit of $1,163,116 in the sinking funds, 19 cents of the tax dollar were required for debt charges.[14] Figures published in *Kansas Municipalities* for April, 1922, show that 33.67 per cent of all taxes levied for local purposes in the cities and towns of that state were required for debt charges during 1921. Since 1920 the net debt of Detroit has increased 259 per cent, while increases in population and assessed values have been negligible.[15]

Facts such as these warrant the conclusion that there has been during the past few years a tremendous increase in the issue of public obligations. The extent to which our state and local governments have contracted debt within the last ten years is indicated in the table which follows.[16]

TABLE VII.—TOTAL ISSUE OF MUNICIPAL AND STATE OBLIGATIONS WITH PER CENT OF TOTAL ISSUED BY EACH GOVERNMENTAL UNIT, 1911–1920 (000's OMITTED)

YEAR	TOTAL ISSUED	PER CENT OF TOTAL ISSUED BY			
		STATES	COUNTIES	SCHOOL DISTRICTS	CITIES, TOWNS, VILLAGES
1911	$396,859	11.83	12.16	7.71	68.30
1912	386,551	8.80	13.12	8.18	69.90
1913	403,246	12.94	15.27	8.43	63.36
1914	474,074	15.37	13.77	8.30	62.56
1915	498,557	12.23	15.70	10.97	61.10
1916	457,140	9.32	22.84	11.29	56.55
1917	451,278	11.66	18.23	9.94	60.17
1918	296,520	13.05	20.73	8.53	57.69
1919	691,518	10.76	32.78	11.19	45.27
1920	683,188	12.82	19.67	14.87	52.64

This table shows that during the ten-year period which it covers the state and local governments of the country threw

[13] *A Report Upon the Community's Outstanding Debt*, June, 1922, by the Cleveland Municipal Research Bureau.

[14] *The Bonded Debt of St. Paul*, by the St. Paul Bureau of Municipal Research, July, 1922

[15] *Detroit's Bonded Debt*, being No. 77 of *Public Business*, published by the Detroit Bureau of Governmental Research, February 15, 1923.

onto the market approximately five billion dollars' worth of securities. On the whole, the figures show that until the war there was a fairly steady increase in the offerings each year. The cessation of construction during the European war is shown by the falling off in the figure for 1918, which is $200,000,000 below the average for the preceding seven years. The resumption of building is reflected in the enormous increase in the figures for 1919 and 1920. Complete figures for 1921 and 1922 are not yet available but it seems safe to assert that municipal issues were marketed during those years at a rate of approximately a hundred million dollars a month or about a billion a year.[17]

It is pertinent to point out here which units of government have been chiefly responsible for increases in local debts. In 1911 municipal corporations proper (cities, towns and villages) issued 68.3 per cent of all state and municipal obligations; in 1920 the proportion had fallen to 52.64 per cent. The decrease in the relative volume of securities issued by cities, towns and villages has been, on the whole, relatively steady. The percentage figures for the other local government units tell a different story. In 1911 issues by the state governments constituted 11.83 per cent of the total; in 1920, 12.82 per cent. County issues were 12.16 per cent of the total in 1911 and 19.67 per cent in 1920; school district issues increased from 7.71 per cent in 1911 to 14.87 per cent in 1920. During the five years 1911 to 1915 state issues averaged 12.23 per cent of the total, county issues 14 per cent, school district issues 8.72 per cent and issues by cities, towns and villages 65.04 per cent. Corresponding figures for the five-year period 1916–1920 are: State, 11.52 per cent; county, 22.85 per cent; school district, 11.36 per cent, and city, town and village, 54.44 per cent. It is evident from

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[16] *Municipal Bond Sales in 1920*, published by the *Bond Buyer*, 1921, pp. 1–5. The total of municipal and state bonds outstanding in April, 1923, was nearly eleven billion dollars; of this sum about a billion and a quarter dollars were represented by state bonds. See L. R. Gottlieb, "Growth in Local Tax Burdens," in *Quarterly Journal of Economics*, Vol. XXXVII, pp. 374–382, reprinted in the *Bulletin of the National Tax Association* for March, 1923 (Vol. VIII, pp. 160–164).

[17] *Commercial and Financial Chronicle*, 114: 355–356; 115: 13, 481, 917, 1473. Issues during the first four months of 1923 totalled $321,572,054; *ibid.*, 116: 2324 (May 26, 1923).

these figures that the responsibility for the increase in municipal issues during recent years lies wholly with the public quasi-corporations of the country—the counties and the school districts, state and city issues showing actual decreases in their proportion of the total. This is all the more surprising when it is remembered that one-half of the funded debt of our states has been incurred since 1917 and one-third of it since the beginning of 1920.[18]

It is a difficult task to assign reasons for the present tendency toward heavy bonding. There are strong *a priori* reasons for holding that it represents nothing more than the natural desire of the present to shift the burdens for the necessities and amenities of urban life to the shoulders of a new generation of taxpayers.[19] This is an explanation which is often met with, but which falls in the category of those easy to make but difficult to substantiate. Other reasons given are the general abandonment of the contract system of constructing public works[20] and the ease with which municipal securities are floated in view of their exemption from the Federal Income Tax Law.[21] There seems also in some quarters to be considerable evidence that the states themselves have added to the burdens of localities by the enactment of legislation whose enforcement is devolved on the local governments.[22]

Though the student of the problem is forced to deal with fragmentary evidence there seems to be no reason to attribute the present increase in local indebtedness exclusively to any

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[18] *A National Survey of State Debts and Securities*, published by the Bank of America, September, 1922, p. 2.

[19] See *e. g.*, address by E. S. Griffing, Controller of New Rochelle, N. Y., in *Proceedings of the National Association of Controllers and Accounting Officers*, 1912, p. 16; *Bulletin of the First National Bank of Philadelphia*, August 15, 1922.

[20] Report of the Municipal Securities Committee of the Investment Bankers' Association of America for 1922, printed in *Commercial and Financial Chronicle*, October 21, 1922; 115; 1806.

[21] *Bulletin of First National Bank of Philadelphia* for August 15, 1922; *Bulletin of National Tax Association*, Vol. VIII, pp. 160–164 (April, 1923), "Typical Abuses in Handling Municipal Bonds," a report of the Committee on Non-partisan Facts of the Institute for Public Service (1923), pp. 2–4.

[22] See *Report of the Committee for an Investigation of the Finances of Municipalities*, Ohio Legislative Reference Department, February, 1915, p. 19; *National Municipal Review*, 4; 256, 453–455 (April, July, 1916); *Report of the (R. I.) Special Commission on Public School Finance and Administration*, 1922, pp. 11–12, but *cf. Report of Special Joint Committee on Taxation and Retrenchment* (N. Y.), Retrenchment Section, 1922, p. 24.

one of these factors. The last score of years have beyond question witnessed a revival of civic pride which has expressed itself in a widespread demand for more and better services from government. To brand this as mere extravagance and as symptomatic of strange, new ailments in the body politic smacks too much of the "good old days" fallacy. Such a charge fails to take into account the obvious fact that for many a community the creation of debt is the price of material progress. In every field of government, moreover, the progress of science has worked revolutions which are fated to transform the physical conditions of urban life. Keeping pace with this newer knowledge has meant a wholesale scrapping of equipment and a replacement which has meant huge outlays. To shoulder upon the citizen and officeholder the heavy responsibility of wilfully creating debts for posterity to pay in order to reap a selfish enjoyment in the present is to ignore one of the obvious teachings of experience, namely, that the demand for a public service always precedes the creation of the machinery by which it may be adequately satisfied. There is this merit in the cry of "extravagance" and the agitation for the adoption of a "pay-as-you-go" policy—they suggest the need for such a revision of local financial policies and such an adjustment between state and local revenue systems as will make more easily possible the routine provision of large public services.

It is in order to point out here also that the size of public debt is not necessarily of primary importance. The questions as to the purposes for which debts are created and the way in which they are administered are of far more moment. The table which follows is intended to show the percentage of the total state, county, school district and municipal bonds issued for each purpose during the past ten years.

Such a table should offer a satisfactory basis for an inquiry into the question of how wise, from an economic point of view, our present bonding policy is. Discussions of this sort have generally turned on the "productive" or "unproductive" nature of the improvements financed by bonding. The term "productive" as used in such discussions has usually been defined to include only such improvements as result in a direct

monetary return to the city.[23] On this assumption, which may be a satisfactory one for accounting purposes, the only *safe* bonding policy would be one directed toward the pro-

TABLE VIII.—PERCENTAGE OF TOTAL MUNICIPAL ISSUES DEVOTED TO EACH PURPOSE, 1911–1920[a]

YEAR	I	II	III	IV	V	VI	VII	VIII	IX	X
1911	4.44	19.02	22.29	8.44	11.94	9.61	4.18	0.86	4.49	14.73
1912	3.85	15.48	23.13	6.72	11.79	7.93	3.43	2.00	4.76	20.91
1913	6.70	12.22	26.87	6.53	13.72	10.31	2.22	0.82	5.06	15.56
1914	1.97	11.95	30.94	6.86	13.27	9.26	1.70	0.74	3.29	20.02
1915	6.44	8.90	27.29	6.30	16.09	6.60	2.00	1.69	5.01	19.68
1916	5.13	8.42	31.16	5.14	15.37	6.08	1.92	0.67	4.02	22.09
1917	3.40	6.30	29.16	7.24	13.35	5.74	2.35	1.48	4.94	26.04
1918	3.27	13.62	22.22	12.02	14.07	4.04	0.84	1.33	8.64	23.22
1919	1.93	8.00	42.81	5.60	14.92	3.59	1.12	1.47	6.98	13.58
1920	1.67	7.95	31.64	5.80	19.00	3.71	2.63	1.74	7.37	18.49

[a] I, Refunding; II, Water, III, Streets and bridges; IV, Sewers and drains; V, Schoole; VI, General Buildings;; VII, Parks and museums, VIII, Gas and electric light; IX, Funding and improvemeuts; X, Miscellaneous. Compiled from *Commercial and Financial Chronicle, State and City Supplements, 1912–1921.*

vision of income-producing utilities. For our purposes such a distinction is illusory and without value. It is in reality a matter of considerable difficulty to make any distinction between productive and unproductive borrowing. It might, for instance, be urged that bonding for the acquisition and improvement of land for park purposes is uneconomical; yet the values added to surrounding property by the proximity of the park might in the end add very little to the tax burden. The same might be said of such apparently "unproductive" improvements as playgrounds, community centers, public baths and municipal forest preserves. If the expenditure, by conservative figuring, can be shown to make a definite addition to the desirability of living in the community, and if it is actively supported by a substantial portion of the citizenship there is good reason to believe that the tax duplicate will progressively show its ability to carry the cost. Such items, however, as large issues for funding and refunding and issues for such purposes

[23] This is the definition used by the Bureau of the Census. An analysis of municipal indebtedness from this point of view may be found in Fred E. Clark, *Purposes of the Indebtedness of American Cities*, University of Illinois Studies in the Social Sciences, 1916; especially Chapter 3.

as ornamental lighting, soldiers' memorials, etc., ought to be scanned with some misgiving, since they too often point to lax methods of financing in the past or to unfounded optimism as to the future.

Some idea as to the trend in public indebtedness may be secured by comparing the average figures for the two five-year periods, 1911 to 1915 and 1916 to 1920. Such a comparison shows that the chief increase in bonding has taken place for the building of streets and bridges. Bonds for such purposes issued during the latter period constitute a considerably larger proportion of the total than the average either for the whole ten years or for the first five-year period. The only other purposes for which increases are recorded are sewers and drains, schools, gas and electric lights, funding and improvements and miscellaneous. The increases recorded in columns IX and X, if it were possible to analyze and distribute them, would probably have but a slight effect on the figures in the other columns. Further analysis shows that during the five-year period 1911 to 1915, 57.87 per cent of all issues were for streets and bridges, sewers and drains, schools, general buildings, and parks and museums—all of which are improvements which add unrealizable assets to the city. During the second five years this percentage was 60.29. The percentage figures for so-called productive purposes—water supply and gas and electric systems—were 14.73 in the period 1911 to 1915 and 10.19 in the period 1916 to 1920. The figures in column I show that there has been, on the whole, a rather steady decrease in the percentage of the total chargeable to refunding operations.

On the whole, the data presented in the table give little support to any theory concerning the extravagance or frugality of our cities in the financing of public improvements during the past decade. Whether the improvements made have been necessary, and if necessary, executed with due economy, are, of course, questions which it is impossible to answer. It is evident, however, that the figures available do not permit of valid generalizations concerning present tendencies.

Short-Term Borrowing

Long-term borrowing, however, represents only a part of

the city's efforts at financing. The magnitude of temporary borrowing in itself constitutes a serious problem. It is a matter of no little importance that our local governments issue and retire annually short-term obligations not much less in volume than their long-term loans. Most of these loans are issued in anticipation of tax collections or the receipt of the proceeds of authorized but unissued bonds. The volume of this short-term financing is shown for the last decade in the following table where it is compared with long-term issues.

TABLE IX.—ANNUAL ISSUES OF SHORT AND LONG TERM LOANS BY AMERICAN MUNICIPALITIES, 1911–1920[24]

YEAR	SHORT TERM PAPER	LONG TERM PAPER	PER CENT SHORT TERM BORROWING TO TOTAL
1911	$190,683,131	$396,859,646	32.2
1912	192,450,139	386,551,828	33.2
1913	483,217,696	403,246,518	51.9
1914	286,054,624	474,074,395	37.6
1915	154,728,247	498,557,993	23.6
1916	292,407,269	457,140,955	39.0
1917	392,443,858	451,278,762	46.5
1918	473,134,727	296,520,458	61.4
1919	451,193,607	691,518,914	39.4
1920	664,087,293	683,188,255	49.3

This table shows that short-term loans make up, on the average, more than 40 per cent of all municipal financing. Their real significance lies in the fact that they are a regularly recurring burden which, in the aggregate, is of considerable importance in municipal finance. No matter how promptly the principal of such issues is paid, the interest charge alone is of some magnitude. The City Controller of New York testified before the Special Joint Committee to Investigate the Affairs of the City of New York that that city is "thrown into the short-term money market for $142,000,000 twice a year, by reason of the failure to advance the tax date, and that it is safe to take as a round figure $150,000,000 for short-term loans on this account."[25] The Special Joint Committee on Taxation and Retrenchment of the New York Legislature reports as follows concerning such borrowing by the cities of that state: "In

[24] From *Municipal Bond Sales for the Year 1920*, published by the *Bond Buyer*, 1921, p. 2.
[25] See *Report on the Finances of the City*, pp. 5–7.

Utica . . . for two-thirds of the year the city is forced to operate on funds borrowed at 4 to 5 per cent interest. The cost of this system for Utica in 1919 alone is placed at $20,000. In Syracuse the cost is $50,000. In New York City the Controller has stated that the cost is approximately $3,000,000 annually."[26] For all the cities in the state the committee estimates, on the basis of payments made in 1919, that the saving which might be effected by advancing the tax date would amount to between three and four million dollars annually.[27]

The State Controller of New York in his special reports on municipal accounts for the years 1919 and 1920 shows that temporary loans for those years account for 8.2 and 9.2 per cent, respectively, of the total indebtedness of the counties, cities and villages of the state.[28] In New Hampshire in 1921 temporary borrowings by the local governments amounted to $3,808,000 and entailed interest charges of $166,000.[29] The following table covering the temporary financing of the ten largest Ohio cities is of interest in this connection.

TABLE X.—TEMPORARY BORROWING IN TEN LARGEST OHIO CITIES, 1914[30]

CITY	ESTIMATED TAX RECEIPTS	TAX LOANS	TAX ADVANCES	TOTAL ADVANCES	PER CENT ADVANCED
Cleveland	$1,823,286	$765,000	$150,000	$915,000	50.0
Cincinnati	1,751,856	.....	.....	300,000	17.1
Columbus	525,850	.....	.....	.....	.....
Toledo	484,458	338,018	194,340	532,358	109.9
Dayton	352,013	75,000	.....	75,000	21.3
Youngstown	238,263	5,000	17,000	22,000	9.2
Akron	296,893	152,000	.....	152,000	51.2
Springfield	133,108	77,000	.....	77,000	62.5
Hamilton	86,752	8,000	40,000	48,000	55.3

There are excellent reasons why cities should be allowed to contract temporary debts. In theory, government begins and ends each year with an empty treasury. It is not the intention

[26] *Report of Retrenchment Section*, p. 19.
[27] *Ibid.*, p. 20.
[28] *Special Reports on Municipal Accounts*, 1919, p. 264; 1920, p. 268.
[29] *11th Annual Report of the New Hampshire State Tax Commission for the Tax Year*, 1921, p. 14
[30] *Report of the Committee for an Investigation of the Finances of Municipalities*, Ohio Legislative Reference Department, February, 1915, p. 32.

of public corporations to build up surpluses or even to have working capital. The difficulties met with in calculating the exact returns from taxes, the probable percentage of uncollected and uncollectible taxes from year to year, and the probable product of miscellaneous sources of revenue, and in foreseeing emergency needs beyond the budget estimates, are in practice insurmountable. For this reason, if for no other, cities should be granted power to make up unforeseen deficits in the revenue and to meet emergencies unforeseen at the time of making the annual financial plans. Moreover, a law which would make such temporary borrowing impossible would undoubtedly make inevitable the creation of floating debts.[31] But, when cities are compelled to borrow a third or a half of their revenues on short-term paper for no better reason than that taxes already levied are not yet collected, the malady would seem serious and the remedy simple.

Most of our state laws allow borrowing in anticipation of taxes for periods not exceeding one year. Some permit repayment during the fiscal year following the year in which the debt is incurred and others require repayment within less than one year. There seems to be no adequate reason why the dates for the payment of taxes should not be advanced sufficiently to permit the city to have a flow of revenue several months earlier than is now the case. A plan for the payment of taxes in installments, coupled with a judicious use of discounts for advance payments and substantial penalties for installments not paid when due, would be entirely feasible and would have obvious merits. It would get taxes into the treasury close to the time when they are needed, it would make it actually easier for many taxpayers to pay their taxes without having to husband and safeguard the full-year's or half-year's taxes and it would spread the tax burden more evenly through the year.[32]

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[31] See on this point the *Report of the (N. Y.) Special Joint Committee on Taxation and Retrenchment*, Retrenchment Section, pp. 69–70; this report contains an excellent brief discussion of the whole subject of temporary borrowing.

[32] See a brief discussion in *Citizens' Business* (Philadelphia Bureau of Municipal Research, for October 12, 1922; Dodds, "Better Methods of Municipal Bonding, in *Annals*, Vol. XCV) pp. 260–261; E. S. Griffing in *Proceedings of the Seventh Annual Convention of Controllers and Accounting Officers* (1912), pp. 15ff.

If the period since 1915 may be taken as normal in respect to the issue of short-term obligations and 5 per cent as the average rate of interest on such paper a saving of two-thirds of the annual interest charge would amount to well over ten million dollars each year. This sum is worth saving.

The delicate nature of public credit is nowhere seen more clearly than in the case of municipalities, and the smaller units of government generally. A national government, buttressed by the patriotic impulses of a united and hopeful people, is able, within broad limits to create and maintain, on favorable terms, a market for its securities; a rich state or a metropolitan city, by the very facts of its wealth or size, may in a measure do the same thing. But for the average city, the maintenance of credit is a mutual accomplishment. Default or tardiness on the part of one city is quite likely to react unfavorably upon the investment standing of the issues of other cities and lower the tone of the whole market for "municipals."[33] The only effective bond existing between cities in their relations to the widely distributed investing public is their common subjection to the same general state laws. The character of the standards established by that law and the machinery created for enforcing compliance with such standards, are the chief factors involved in the development and maintenance of credit for the vast majority of local governments. The next three chapters of this study are devoted to an examination of existing laws concerning municipal indebtedness.

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[33] See H. W. Dodds, "Better Methods of Municipal Bonding," in *Annals*, Vol. XCV, pp. 258ff (May, 1921). This point is strikingly illustrated by the present situation in the state of Washington where nearly all the cities have defaulted on their special assessment bonds. Failure to meet payments on these bonds has caused the interest rate on bonds for general municipal purposes to rise in some cases to 8 per cent and to average 6 per cent; this in spite of the fact that the bonds in default were not *legally* binding obligations on the cities. See *National Municipal Review* for February, 1923, Vol. XII, pp. 92–93.

II

Constitutional Provisions Concerning Municipal Debts

Constitutional restrictions on local borrowing powers came much later in our history than those applying to state governments. So far as the latter are concerned debt restrictions were general as early as 1857. Their "proximate causes were the unwarranted expansion of credit in financial and industrial ventures which either because of their inherent difficulties or bad management ceased to be profitable and because the fear of heavy taxation had been replaced by actual taxation."[1] The same causes operated to cause similar limitations to be placed on municipal borrowing. Prior to the panic year 1873 comparatively little notice seems to have been taken of local debts. Although the ventures of cities into private industrial enterprises by way of pledges of public credit were accompanied by the same baneful results which attended like experiments on the part of the state governments, the recently adopted prohibitions against the lending of state credit to private enterprises were, strangely enough, not construed as applying to the minor subdivisions.

The crisis of 1873 gave an opportunity for a full, if somewhat hysterical discussion of the whole question of municipal indebtedness and the serious nature of the situation was exposed.[2] Bankers, lawyers, scholars and laymen united in presenting the evil features of municipal debt.[3] The public judgment expressed itself in root-and-branch methods of dealing with the question. The reasoning of the time—and it was quite logical, granting the premises and considering the stage of political development at which we had arrived—was well expressed by Bradstreet's: "But as all experience shows that the use of public credit by

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[1] See Horace Secrist, *An Economic Analysis of the Constitutional Restrictions Upon Public Indebtedness in the United States*, p. 54, University of Wisconsin Bulletin No. 637 (1914).

[2] See Secrist, *op. cit.*, Chapter 1 of Part II for a discussion of the extent of public indebtedness at this period.

[3] *Bankers' Magazine* (third series), Vol. X, p. 946; Vol. XI, 183; *Commercial and Financial Chronicle*, May 15, 1875, p. 464; J. F. Dillon, *The Law of Municipal Bonds*, p. 5.

local officials defies successful regulation, it follows that the primary error was in the original grant of the power to borrow money."[4]

With the perspective of half a century it is not difficult for us to see the problem as it presented itself to citizens and reformers of the early 'seventies. The mere increase in urban population laid a burden on the governmental machinery which in itself must have been bewildering. It is also pertinent to point out that municipal efficiency was probably at its lowest point during the two decades prior to 1870 and conservative citizens must have despaired of securing effective administration of the public trust by men kept in office for purely partisan reasons. Moreover, those in favor of strict regulation in the interest of conservative financing would turn in vain to the state governments. There existed almost nowhere an administrative organization competent to supervise local affairs. Assuming, as men did, that the very grant of borrowing powers was wrong, it is not strange that the only adequate remedy seemed to lie in so amending the organic law as to restrict this right within the narrowest compass and to make illegal its abuse. The restrictions in our constitutions on local borrowing power are for the most part the fruit of that period of constitution-amending which extended roughly from 1865 to 1880.

General Constitutional Provisions

Great variety exists among our state constitutions in their treatment of the problem of municipal debt. In twelve states the constitutions make no direct or indirect mention of the subject.[5] Many others contain no direct restriction on borrowing but do contain clauses which assume its authorization by law, or which tacitly acknowledge its existence and attempt to surround it with certain safeguards. For example, the constitutions of about one-third of the states provide that the legislature shall restrict the power of local governments to incur debts and impose taxes in order to prevent the abuse of such

[4] *Bradstreet's* for May 22, 1880, p. 4, quoted in Secrist, *op. cit.*, p. 59.

[5] Connecticut, Delaware, Florida, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, North Carolina, Rhode Island, Tennessee and Vermont.

powers. In addition to these about thirty states in their constitutions prohibit, either absolutely or with certain qualifications, the lending of credit by their minor subdivisions.[6] Aside from the twelve states mentioned above all the others have placed in their constitutions more or less detailed provisions regarding the incurring of debt by minor political subdivisions. These provisions vary all the way from bare statements of percentage limitations on borrowing power to those so detailed as to be legislative in character. These provisions will be considered topically.

Percentage Limitations

Most of the state constitutions which make any attempt at all to deal with the question contain at least a limitation on the borrowing power expressed in terms of a percentage of the taxable property within the corporation. The next table presents in concise form this portion of the constitutional treatment of the question. This table refers only to the minimum limits and does not deal with the percentages by which debt may exceed the limits under certain prescribed conditions to be discussed later.

Of the twenty-six states appearing in this table fifteen prescribe limits of 5 per cent and less. Nine permit debt up to 10 per cent of the assessed value of property. Only two permit debt in excess of 10 per cent. Other states while setting no percentage limits to local debts, attempt to surround the incurring of debt with certain other safeguards. California, for example, sets no percentage limit in its constitution but provides that no debt shall be incurred in any one year in excess of the income of the year without the approval of two-thirds of the people and requires further that a tax shall be laid at the time sufficient to retire the debt in forty years.[7] The constitution of Utah contains an almost identical provision[8] and Wyoming requires the approval of the people for any loan in excess of the

[6] The provisions against the lending of credit are discussed briefly in *Bulletin No. 14*, of the Massachusetts Constitutional Convention (1917–1918), Vol. I, pp. 526–527.

[7] Art. XI, 18. [8] Art. XIV, 3, 4.

taxes of the current year.[9] Idaho also requires a two-thirds vote of the people for such loans and makes mandatory the retirement of all debts in not over twenty years.[10]

TABLE XI.—MINIMUM PERCENTAGE LIMITATIONS ON DEBT-INCURRING POWER

STATE	PER CENT	LIMIT	REFERENCE
Alabama	5.7	Assessed value of property.	Sec. 225.
Arizona	4	Assessed value of property.	IX, 8.
Arkansas	7	Assessed value of property.	XVI, 1.
Colorado	3	Assessed value of property.	XI, 8.
Georgia	7, 10	Assessed value of property.	VII, 7.
Illinois	5	Assessed value of property.	IX, 12.
Indiana	2	Assessed value of property.	XIII, 1.
Iowa	5	Assessed value of property.	XI, 3.
Kentucky	3, 5, 10[2]	Assessed value of property.	Sec. 156.
Louisiana	10	Assessed value of property.	XIV, 14.
Maine	5, 7½[3]	Assessed value of property.	Amend. 34.
Missouri	5, 10[4]	Assessed value of property.	X, 12.
Montana	3	Assessed value of property.	XIII, 6.
New Mexico	4	Assessed value of property.	IX, 13.
New York	10[5]	Assessed value of real estate.	VIII, 10.
North Dakota	5	Assessed value of property.	Amend. 35.
Oklahoma	5	Assessed value of property.	X, 26.
Pennsylvania	7, 10	Assessed value of property.	IX, 8.
South Carolina	8, 15[7]	Assessed value of property.	VIII, 7; X, 5.
South Dakota	5	Assessed value of property.	XIII, 13.
Utah	4	Assessed value of property.	XIV, 3, 4.
Virginia	18[8]	Assessed value of property.	Secs. 127, 128.
Washington	1½, 5	Assessed value of property.	VIII, 6.
West Virginia	5	Assessed value of property.	X, 8.
Wisconsin	5	Assessed value of property.	XI, 3.
Wyoming	2	Assessed value of property.	XVI, 5.

[2] Five per cent if under 6,000 population; 7 per cent if over 6,000.

[3] Under 3,000 population, 3 per cent; 3,000 to 15,000 population, 5 per cent; over 15,000 population, 10 per cent.

[4] Five per cent if under 40,000 population.

[5] Five per cent if under 75,000 population; 10 per cent if over 75,000 population and approved by two-thirds vote of people.

[6] New York City operates under this limit but certain exemptions are made in the case of revenue-producing utilities.

[7] Ten per cent limit applies to Philadelphia, with certain exemptions for municipally owned utilities.

[8] Same territory not to bear debt in excess of 15 per cent if covered by more than one corporation having power to incur debt.

[9] Limit does not apply to cities whose charters existing at the time of the adoption of the present constitution (1902) authorized a larger percentage of indebtedness.

[10] All debt over the 1½ per cent limit must be approved by three-fifths vote of the people; with such approval debt may be increased to 5 per cent of the assessed valuation.

[9] Art. XVI, 4, 5. [10] Art. VIII, 3.

Generally speaking the power to borrow is extended on the same terms to all subordinate political units. Where the power is given simply to "municipal corporations," this latter term is held, in most cases, to apply to all minor divisions, with the result that several tax-levying and debt-incurring authorities may, and often do, occupy the same territory.[11] Examples of this situation are seen in Cook County, Illinois, where the same territory supports a municipal and a county government and several park and sanitary authorities. In New Hampshire, under the loose definition of "municipal corporations" given in the Municipal Bond Act of 1895, it is possible to have eleven different governmental agencies covering the same territory. Under the law of that state which limits the debt of municipal corporations to 5 per cent of the assessed value of property it is thus possible to bond a district to the extent of 55 per cent of its taxable value and still keep within the law.[12] Only one of our state constitutions recognizes this possibility. The constitution of South Carolina, after limiting the bonded debt of political subdivisions to 8 per cent of the valuation of the taxable property, provides that "whenever there shall be several political divisions or municipal corporations covering or extending over the same territory or portions thereof, possessing the power to levy a tax or contract a debt, then each of such political divisions or municipal corporations shall so exercise its power to increase its debt under the foregoing 8 per cent limitation that the aggregate debt over and upon any territory of this state shall never exceed 15 per cent of the value of all taxable property in such territory as valued for taxation by the state."[13]

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[11] The independent borrowing power of each of several authorities occupying the same territory is affirmed in numerous decisions. See *e. g., Heinl v. City of Terra Haute*, 161 Ind. 44–49; *Campbell v. City of Indianapolis*, 155 Ind. 186, 210–213; *Paine v. Port of Seattle*, 70 Wash. 294, 320–321.

[12] Recent concrete data on this point may be found in the *Report of a Special Investigation Relative to Municipal Finances and Accounts*, by the New Hampshire State Tax Commission January 1, 1917, pp. 14–17; and in *Report of the Commission for the Survey of Municipal Financing* (N. J.), p. 30.

[13] Art. X, Sec. 5.

Borrowing "Outside the Debt Limit"

The table and discussion above deal with the constitutional limitations on borrowing for what we may call "general municipal purposes." To find the absolute limit beyond which the city may not obligate itself it is necessary to note the extent to which loans may be contracted for other than general municipal purposes. In very few instances is the limit discussed above absolute. Table XII shows the limit for general purposes, the additional borrowing power available for other purposes and the absolute limit where it is possible to compute it.

It is seen from this table that the additional borrowing power permitted in only a few cases makes possible an indebtedness in excess of 15 per cent of the assessed valuation. In those cases where no absolute limit is specifically set the additional debt is usually made burdenless by permitting it only for revenue-producing utilities. Such exemptions from the general limit are made only in case the operation of the utility earns a net income over and above all carrying charges. The plan outlined in the constitution of Virginia is followed in its essentials in New York and Pennsylvania.

The constitutions of several states go still farther in allowing cities to incur debt outside the debt limit for the acquisition of utilities. The new constitution of Louisiana provides that cities may be permitted by the legislature to execute a mortgage on the improvement and make the payment of interest and sinking-fund charges a charge only upon the revenues of the utility, with the express understanding that such indebtedness is not to be considered a general municipal liability.[14] The constitutions of Ohio and Michigan contain similar clauses with the additional proviso that the mortgage may be secured by a franchise stating the terms upon which, in case of foreclosure, the purchaser may operate the utility.[15] Missouri cities of over 75,000 population may follow a similar procedure which is outlined in considerable detail in the constitution.[16]

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[14] Such enabling legislation was passed in 1921; Nos. 70 and 80, Extra Session, 1921.
[15] Ohio, Art. XVIII, 12; Michigan, VIII, 24.
[16] Art. X, 12; this is an amendment of 1920; see Laws of 1919, p. 751.

TABLE XII.—PURPOSES FOR WHICH DEBT MAY BE CONTRACTED OUTSIDE THE GENERAL LIMIT OF INDEBTEDNESS

STATE	LIMIT FOR GENERAL PURPOSES. PER CENT	ADDITIONAL BORROWING POWER FOR[1]	ABSOLUTE LIMIT
Alabama	5, 7	3 per cent for utilities, sewerage, and street improvements.	8, 10 per cent.
Arizona	4	15 per cent for water, light, and sewers.[2]	19 per cent.
Colorado	3	Water supply debt exempt.	Not specified.
Georgia	10	City of Augusta may exceed for certain purposes.	Not specified.
Indiana	2	War, invasion or public calamity.[3]	Not specified.
Louisiana	10	Bonds secured by acreage tax and bonds for revenue-producing utilities exempt.	Not specified.
Maine	5, 7½	War loans (Civil War); trust funds used not included in debt.	Not specified.
Missouri	5, 10	10 to 20 per cent additional for revenue-producing utilities; additional amount depending on population.	15 to 25 per cent.
Montana	3	Additional for sewerage and water supply if approved by people at election authorized by legislature.	Not specified.
New Mexico	4	Additional for water supply and sewerage.	Not specified.
New York	10	Water debt exempt. Special provisions for New York City.	Not specified.
North Dakota	5	3 per cent additional for revenue-producing utilities if approved by ⅔ vote of people; 4 per cent additional for water supply or sewerage.	12 per cent.
Ohio	None	Mortgage bonds for public utilities and bonds to buy land under excess condemnation proceedings, both expressly exempted from any statutory debt limit.	Not specified.
Oklahoma	5	Municipal utility bonds exempt if approved by majority vote of people.	Not specified.
Pennsylvania	7, 10	Utility bonds if plant earns interest and sinking fund charges for 5 years prior to acquisition.	Not specified.

TABLE XII.—PURPOSES FOR WHICH DEBT MAY BE CONTRACTED OUTSIDE THE GENERAL LIMIT OF INDEBTEDNESS.—*Continued.*

STATE	LIMIT FOR GENERAL PURPOSES. PER CENT	ADDITIONAL BORROWING POWER FOR	ABSOLUTE LIMIT
South Carolina.	8, 15	Debt contracted to pay previously contracted valid debts exempt.	Not specified.
South Dakota..	5	10 per cent additional for water supply and sewerage; 3 per cent additional for cities over 8,000 population for acquisition of street railways.	8, 15, 18 per cent.
Utah.....	4	4 to 8 per cent additional for water, light, and sewerage.	8, 12 per cent.
Virginia.....	18	Water debt exempt.	Not specified.
Washington....	1½, 5	5 per cent additional for water, light and sewerage.[5]	10 per cent.
Wyoming.....	2	4 per cent additional for sewers; water debt exempt.	Not specified.

[2] In addition to the purposes listed in this table, refunding loans and temporary borrowings are exempt from the general limits, under various conditions.

[3] If approved by a majority vote of the property-owning voters.

[3] Additional debt is allowed in such cases when petitioned for by a majority of the citizens.

[4] Water supply debt is exempt from the limit if its creation is approved by a majority vote of the people and the earnings of the plant are sufficient to yield a net income over operation and maintenance charges and interest and sinking fund requirements.

[5] Three-fifths vote of the people required for all debt in excess of the 1½ per cent limit.

This method of exempting public utility debts from the general debt limit has within recent years become quite generally incorporated in state laws. It is interesting to note also that the constitutional provisions cited here were all adopted since 1908.[17]

Where the mortgage plan is not adopted it is usual to place in the constitution other provisions intended to safeguard the taxpayer. The most usual of these is the requirement that the utility in aid of which bonds are issued shall be owned and controlled by the city.[18] In Montana debt beyond the 3 per cent

[17] Michigan, 1908; Ohio, 1912; Missouri, 1920; Louisiana, 1921.

[18] Arizona, IX, 8; Oklahoma, X, 27; Utah, XIV, 4; Washington, VIII, 6. It is difficult to see how, in practice, this would offer much protection, in the absence of more definite provisions as to the management of the utility. In most cases, however, such provisions are found in the laws.

limit may be contracted only for water supply and sewerage and then only in case the legislature authorizes the locality to submit the question to popular vote, when it must be approved by a majority of those voting. In other states, debts for utilities, though exempt from the general limit, may be authorized only by popular vote.[19]

The Basis of the Power to Incur Debt

It will be observed from the preceding discussion that the power to incur debt is based upon the assessed value of the taxable property within the corporate limits. This use of assessed value as a basis is doubtless due to the desire to find a relatively stable element in community wealth which would furnish an index of debt-paying ability. An additional security against local extravagance is supplied by the usual requirement that the value used shall be that used by the state or county in levying taxes. Perhaps no feature of our plan of constitutional control of local debt is more open to criticism on strictly theoretical grounds.

In the first place, there is no necessary relationship between the assessed value of property and the community's need for improvements or its ability to finance such needs. The relation between taxable values and *present* needs is obviously much more direct and logical. Bonded debt, however, is from the point of view of public economy, a convenient device for the equitable distribution of public financial burdens between the present and the future. The question before the community, then, is how great a future burden they are willing to assume over and above what can reasonably be defrayed from current taxes. It seems rather obvious that popular willingness to assume such burdens has no direct relationship to assessed value of property. Probably the most that can be said in favor of such a basis for debt-incurring power is that real increases in property values, by widening the tax base, *do* indicate ability to pay debts. But they do not indicate either the real needs

[19] This is true in Arizona, North Dakota, Oklahoma, Virginia and, of course, in those states where a popular vote is required on all propositions to incur debt.

of the community nor the *amount* of debt which it may safely incur.[20]

In the second place, if we view the incurring and payment of debt as a problem of interest to cities generally, the use of assessed value as a basis for debt-incurring power lays itself open to a more practical objection. When it is remembered that, with few exceptions, the assessment of property is made by locally-elected officials, the lack of real meaning of assessed value is apparent. Were adequate central control possible something like uniformity in assessments might be achieved and this difficulty overcome. It is extremely doubtful, however, if a large degree of central control is possible of realization under American conditions. As it is, however, the existence of many hundreds of assessing authorities deprives assessed value of all real meaning as a basis for the creation of debt. A tabulation of the bases of assessment used in American cities of over 30,000 population shows the widest variation in the bases used. The table below shows these variations.

TABLE XIII.—BASES OF PROPERTY ASSESSMENT USED IN AMERICAN CITIES OF OVER 30,000 POPULATION[21]

PERCENTAGE OF FULL VALUE	NUMBER OF CITIES	PERCENTAGE OF ALL CITIES	STATES IN WHICH LOCATED
100 per cent	97	42.7	17
95 per cent	5	2.2	3
85 per cent	8	3.5	4
80 per cent	10	4.4	6
75 per cent	13	5.7	9
70 per cent	14	6.1	10
67 per cent	11	4.8	6
65 per cent	4	1.7	3
60 per cent	13	5.7	6
55 per cent	3	1.3	3
50 per cent	14	6.1	8
45 per cent	3	1.3	3
40 per cent	12	5.3	8
30 per cent	1	0.4	1
25 per cent	12	5.3	3
20 per cent	7	3.1	2

[20] See Horace Secrist, in *Journal of Political Economy*, Vol. XXII, pp. 369ff.
[21] Bureau of the Census, *Financial Statistics of Cities*, 1919.

Under present conditions Philadelphia has four times the borrowing power of Chicago; Utica, N. Y., four times that of Des Moines. The cities of Massachusetts, where assessments are reported as made at full cash value, have five times the debt-incurring power of cities approximately the same size in Iowa and Nebraska. Not only is there such variation between cities in different states—wide discrepancies exist between those in the same state. The important point in this connection is that the investment value of municipal securities cannot be judged by the fact that *some* cities in a state give real meaning to assessed value. Sound public credit cannot be a mutual accomplishment where such wide variations exist.

On the other hand, in practice something may be said in favor of using assessed valuation as a basis for the creation of debt. The constructive critic finds it on the whole difficult to suggest a better basis, at least one which could be placed in a state constitution. It is a sound principle of constitution making that the organic law should contain general, rather than detailed provisions. Better methods, to be sure, may be incorporated in statutes and enforced by administrative authority. This, however, is a counsel of perfection. As long as we attempt to deal with such questions by definite constitutional provisions, the constitution-maker will be forced to deal in generalities rather than in details. Looked at from this point of view, assessed value has the advantage of being a relatively stable element indicating tax-paying ability, the character of which is enough similar in all places to endow its use with a rude sort of proximity to justice. Moreover, "practice seems to justify constitutional debt limits. The market demands them, since there appears to be no other way to estimate a city's borrowing power than as a percentage of taxable property. A city's balance sheet is meaningless as a guide in undertaking new enterprises."[22]

Requirements as to Redemption

While the state constitutions may be said, on the whole, to contain rather full provisions regarding the amount and

[22] H. W. Dodds, "Better Methods of Municipal Bonding," in *Annals*, Vol. XCV, p. 260.

purposes of local debts, much less is found concerning their repayment. Although a comprehensive program to be followed in local financing is perhaps not desirable in the fundamental law, it would seem that the point of view which prescribed percentage limitations would consider equally important the questions of maturity and means of repayment. Yet less than half the states make mandatory the creation and maintenance of sinking funds or provide for other methods of retirement, and only twelve states limit by their constitutions the maturity dates of local funded debts.

The most common constitutional requirement as to repayment is that at the time of incurring the debt the legislative body of the city shall levy a tax (by irrepealable ordinance) sufficient to retire the indebtedness within a specified number of years or simply "when due." In a few cases the tax for debt charges is definitely stated or limited in amount. Thus, the constitution of Colorado requires a tax to be levied at the time of the creation of the debt not to exceed 12 mills and makes mandatory the repayment of all debts in not less than ten nor more than fifteen years. A 12-mill limitation is also found in the New Mexico constitution, with a maximum maturity limit of fifty years.[23] The Texas constitution makes mandatory an annual tax which shall equal 2 per cent of the principal of the debt, but does not limit the time within which retirement must be accomplished.[24] The constitution of Louisiana of 1921 limits the maturity of funded debts to forty years, makes mandatory the collection of an annual tax for interest and sinking-fund requirements, and provides explicitly that this levy may be enforced by the courts or imposed and collected by state officials.[25] The North Dakota constitution simply requires that a tax shall be levied sufficient to pay the principal and interest of debts "when due" and South Dakota and South Carolina have similar provisions.[26] These requirements as to repayment of indebtedness are shown in the table which follows.

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[23] Colorado, XI, 8; New Mexico, IX, 12.
[24] Art. XI, 5.
[25] Art. XIV, 14i, j.
[26] North Dakota, Sec. 184; South Dakota, XIII, 5; South Carolina, VIII, 7.

TABLE XIV.—CONSTITUTIONAL REQUIREMENTS AS TO REDEMPTION

STATE	TAX REQUIREMENT[1]	REFERENCE
Arkansas	Sufficient to repay within thirty-five years; not to exceed 7 mills.	XVI, 1.
California	Sufficient to redeem in not over forty years.	XI, 18.
Colorado	Tax of not over 12 mills to repay in not less than ten nor more than fifteen years.	XI, 8.
Georgia	Sufficient to retire in not over thirty years.	VII, 7.
Idaho	Sufficient to retire in not over twenty years.	VIII, 3.
Kentucky	Sufficient to retire in not over forty years.	Sec. 159.
Louisiana	Sufficient to retire in not over forty years.[2]	XIV, 14.
Missouri	Sufficient to retire in not over twenty years.	X, 12.
New Mexico	Not over 12 mills; to retire in not over fifty years.	IX, 12.
North Dakota	Sufficient to pay principal and interest when due.	Amend. 35.
Oklahoma	Sufficient to retire in twenty-five years.	X, 27, 28.
Pennsylvania	Sufficient to retire in not over thirty years.[3]	IX, 8.
South Carolina	Sufficient to retire at maturity.	VIII, 7
South Dakota	Sufficient to pay interest and principal when due.	XIII, 5.
Texas	Equal to 2 per cent of the principal annually.	XI, 5.
West Virginia	Sufficient to redeem in not over thirty-four years.	X, 8.
Wisconsin	Sufficient to redeem within twenty years.	XI, 3.

[1] Only two states have constitutional tax limitations which apply to debt charges: Arkansas and Alabama have 5-mill limitations which apparently apply to all local purposes including debts; Colorado and New Mexico, as pointed out, have 12-mill limitations. In all other cases tax limits do not apply to debt charges.

[2] Applies only to sinking fund bonds outstanding at time of adoption of the 1921 constitution. All future issues are to be on the serial plan.

[3] Philadelphia may issue bonds for periods as long as fifty years.

The next table shows the periods for which bonds may be issued in the states whose constitutions limit the period.

TABLE XV.—CONSTITUTIONAL RESTRICTIONS ON TERM OF LOANS

Fifteen years:
Colorado.
Twenty years:
Idaho.
Illinois.
Missouri.
Wisconsin.[1]
Twenty-five years:
Oklahoma.
Thirty years:
Georgia.
Pennsylvania.
Thirty-four years:
West Virginia.
Thirty-five years:
Arkansas.
Forty years:
California.[2]
Kentucky.
Louisiana.
Fifty years:
New Mexico.

[1] Debts for the acquisition of land for municipal purposes may run for fifty years.
[2] This is the general limit for California cities; San Francisco, San Jose and Santa Clara, however, may incur debts for a period of seventy-five years.

AUTHORITY FOR THE CREATION OF DEBT

The constitutional provisions regarding the authorization of municipal indebtedness may be divided into three classes: First, those which allow the legislative body to take the initiative in public borrowing; second, those which require popular approval of *all* issues, and third, those requiring that a popular vote must be taken on loans for certain purposes or beyond a certain specified limit.

Twelve state constitutions make no mention, direct or indirect, of municipal indebtedness. Of the remaining thirty-six, twenty contain no express provision as to the debt-incurring authority and the power is presumably in the hands of the legislative body. The other sixteen require popular approval of some sort.

A majority vote of the people on *all* issues is required in the following states: Colorado,[27] Louisiana,[28] New Mexico,[29] South Carolina,[30] South Dakota,[31] and Utah.[32] A two-thirds vote is required in Georgia,[33] and Missouri,[34] while a three-fifths vote is necessary in Oklahoma and West Virginia.[35]

[27] Art. XI, 8.
[28] Art. XIV, 14.
[29] Art. IX, 12.
[30] Art. VIII, 7.
[31] Art. XIII, 4.
[32] Art. XIV, 3, 4.
[33] Art. VII, 7.
[34] Art. X, 12.
[35] Oklahoma, X, 26; West Virginia, X, 8

The remaining states require popular votes on issues under various circumstances. Thus, Arizona allows indebtedness up to 15 per cent of the assessed value of taxable property above the 4-per-cent general limit, for water, lights, and sewers, if approved by a majority vote of the tax-paying voters.[36] Kentucky requires a popular vote when a debt is to be incurred in any one year in excess of the income of the year;[37] Pennsylvania for all debt in excess of the 2-per-cent limit,[38] and Washington a three-fifths vote of the people on all debt in excess of the 1½-per-cent limit.[39] Even in the states where the constitutions are silent on this point, an examination of the statutes shows an almost universal prevalence of such requirements.

It accords well with our traditional theories of government that questions directly affecting the public purse should be decided by vote of the holders of the purse. It is doubtful, however, if under present conditions this requirement serves any very useful purpose. With rare exceptions the use of the referendum in such cases has been disappointing and the presumption has some weight that decisions so made are of little real value. The Special Joint Committee on Taxation and Retrenchment of the State of New York adduces figures to show that a vote of 50 or even of 30 per cent on bond issues in the cities of that state is exceptional. It is the view of the committee that "it is invariably the opposition rather than those in favor of the project that comes out to vote on these occasions. Extraneous matters are usually brought in with the result that the electors refuse to authorize the issue of bonds for projects that have already been popularly approved."[40] In its summary of conclusions on this point the committee recommends "that the governing body of the municipalities be given the power to authorize bond issues. In order, however, to prevent any bond issues being forced through in the face

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[36] Art. IX, 8.
[37] Sec. 157.
[38] Art. IX, 8.
[39] Art. VIII, 6.
[40] *Report of the Special Joint Legislative Committee on Taxation and Retrenchment*, Retrenchment Section (March, 1922), pp. 73–74; several typical cases of recent bond elections are cited in *National Municipal Review*, May, 1923, Vol. XII, p. 257.

of unquestioned popular disapproval such power should be subject in third-class cities to referendum on petition of a substantial portion of the voters."[41] This decision of the committee rests upon what has come to be recognized as a fundamental proposition of political science, namely, that the efficient performance of public duties depends in the last analysis upon the integrity of the people's public servants. The responsibility for making decisions in matters requiring exact knowledge and complete familiarity with financial practices and market conditions may more safely be left in the hands of those accustomed, at least a part of the time, to deal with such questions than to the unreasoning whims and ill-informed judgment of the electorate.

The proposal that referenda be required only in case a substantial portion of the voters demand them has great practical merits. It would allow the initiative in city financing to rest with those presumably best able to take it. At the same time, it would give to those truly in interest—the progressive and wide-awake and public-spirited in the community—the opportunity to avail themselves of any benefits which might inhere in a referendum held at a time when public interest, by the very fact of the protest, would be focussed on the merits of the single issue.

Constitutional Provisions for Validation

Three states only make provision in their constitutions for state validation of municipal bonds. The North Dakota constitution provides that no bond shall be valid unless certified by the county auditor or other authorized officer to have been issued pursuant to law and to be within the debt limit.[42] Almost identical provisions occur in the constitutions of Oklahoma and Wyoming.[43] The Louisiana constitution of 1921 provides

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[41] *Ibid.*, p. 74. See also an address by Mr. William Henry Hoyt of the firm of Reed, Dougherty, and Hoyt before the 14th Annual Convention of the League of Virginia Municipalities, September 23, 1919, printed in the *Bulletin of the National Tax Association* for January, 1920, 5: 109. The suggestion of the New York Committee follows the practice of New Jersey townships and boroughs under the New Jersey Bond Act of 1916. See Chapter 4.

[42] Section 187.

[43] Oklahoma, X, 29; Wyoming, XVI, 8.

that if the legality of a bond issue is not questioned within sixty days after the promulgation of the result of the bond election, the legality of all proceedings shall be conclusively presumed and no court shall have authority to inquire into such matters.

Conclusions

Certain general conclusions may be drawn from the data presented in this chapter. First of all, few of our states have attempted to incorporate in their constitutions a comprehensive program for the handling of local financial questions.[44] The general brevity of the provisions is probably due to the peculiar origin of constitutional restrictions on the debt-incurring power. Born of bitter experience, these restrictions represent an uncritical reaction toward a perfectly legitimate, if much abused, financial device. The immediate problem was to deprive local governments of a power felt to be evil in its very nature when in the hands of local officials. A single prohibition was felt sufficient to accomplish the end in view. Any wisdom shown in thus limiting the number of such prohibitions must, we conclude, be looked upon as entirely fortuitous.

The great difficulty of amending constitutions should argue against the inclusion of elaborate provisions concerning a subject which, by its very nature, has few unchanging elements. "Because of the flexibility of financial practices, the regulations imposed on municipalities should be readily amendable. Nothing, therefore, should appear in the constitution except the amount of debt which local governments can incur."[45] A broad grant of power to municipalities concerning the details of borrowing, safeguarded by some form of central supervision in the interests of the taxpayer, would give the needed flexibility which cannot be obtained by constitutional provisions, general in form, and applied with strict literalness to widely different

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[44] The recent constitution of Louisiana is an exception to this statement, since it contains rather complete provisions covering all phases of municipal indebtedness.

[45] H. W. Dodds, "Better Methods of Municipal Bonding," in *Annals*, Vol. XCV, p. 260 (May, 1921).

situations. The experience of several of our states which have adopted comprehensive plans for local financing indicates that the problem of debt control is one for legislative and administrative treatment. The attitude of the bond houses and investors generally will always have a determining influence on local debt policy. The influence of this element will make itself felt more directly and effectively when the evils to be corrected are within the competence of the legislature, rather than embalmed in a slowly changing and often well-nigh unchangeable instrument.

III

Statutory Provisions Concerning Municipal Debts

The statutory provisions of the forty-eight states concerning the subject of local indebtedness are so extensive and so intricate as to defy generalization. Most of them, however, have, on paper at least, minute legislation on the subject. Very few have anything which can fairly be called a scientific treatment of the problem, drafted with knowledge of the conditions to which it is to apply. A careful search of the laws in force enables us to say that there is in most states some attempt to control the following features of local debt:

1. The amount of debt which may be incurred.
2. The purposes for which debt may be incurred.
3. The depositary of the debt-creating power—*i. e.*, whether vested in the legislative body or dependent on popular vote.
4. The form of the obligation and the method of repayment.
5. Registration of the details of local indebtedness with some central authority.
6. Validation by state authority.

In addition to these there are usually special provisions governing the issue of bonds for the acquisition of municipal utilities. The more important of these provisions will be discussed in this chapter.

General Nature of Statutory Provisions

In few cases do the provisions dealing with the matters listed above give evidence of being part of any deliberate plan. Diligent search is necessary to bring together, in the case of most states, the clauses and statutes dealing with those problems of municipal borrowing which may fairly be called important. It is only with recent years that the pressure of opinion among the investing public and the friends of efficient government has forced a few states to deal constructively with the problem. It is the purpose of this chapter to pass in review the present statutory regulations of municipal borrowing, reserving for later and more

extended treatment those schemes which have been adopted in response to comparatively recent agitation.

So far as the statutes deal with the subject matter covered by the constitutions there is very little tendency to deviate from the provisions of the latter. In such matters as the percentage limitations, the maximum maturity periods and the purposes for which money may be borrowed, it is generally true that the statutes take advantage of the upper limits imposed by the constitution. In only a few cases are local governments more restricted by the law.

The Authorization of Indebtedness

In the matter of the authorization of local indebtedness the statutes are, of course, much more specific, and on the whole, somewhat more restrictive than the constitutions. The requirement of popular sanction for loans is well-nigh universal and is made in some cases more difficult of fulfillment than the constitutional requirement would be. The statutory grants of power to incur debt may be divided into the following classes: (1) Those granting a limited initiative to the governing body; (2) those requiring a popular vote on the question; (3) those placing the initiative with the people to be exercised by petition to the city officials. One state requires the sanction of a state authority in certain classes of cases.

In three states only does the governing body have anything like full discretion in the incurring of debt. The law of Nevada provides that the legislative body shall have power to incur debts on its own motion except for the acquisition of utilities.[1] Loans for emergencies must be approved by the State Board of Finance.[2] The present New Jersey law vests authority to contract debt in the governing body but limits this somewhat by providing that in boroughs and townships an election must be called in case taxpayers representing 10 per cent of the property in the corporation protest against the proposed debt. At the ensuing election a majority vote is required to approve

[1] Sec. 794, subsec, 5, *Revised Laws of Nevada.*

[2] Sec. 11, Ch. 149, *Laws of 1917*, and Ch. 217, *Laws of 1921*. The State Board of Finance is composed of the Governor, State Treasurer, and State Controller.

the loan.[3] With certain exceptions the North Carolina Municipal Finance Act of 1917–1921 places discretion in the local council.[4] A recent Mississippi law gives the governing body in cities of less than 12,000 population power to incur debt unless a petition filed by 20 per cent of the citizens protests the action in which case the approval of a majority must be secured at a special election.[5]

The other states in which a popular vote is not mandatory *in all cases* give even less authority to the legislative body. The usual limitation is to require a popular vote on all issues in excess of the lower limit of indebtedness imposed by the statute. Thus in Ohio cities the council has complete authority up to 2½ per cent of the assessed value of the taxable property in the city; debt between this limit and the absolute limit for general municipal purposes, which is 5 per cent, requires the approval of a majority of the electors voting at a special election.[6] In Pennsylvania the same requirement is imposed for loans in excess of the 2-per-cent limit.[7] In Washington a three-fifths vote is required for all loans in excess of 1½ per cent of the assessed value of the property subject to taxation.[8]

The states other than those mentioned above allow no initiative to the legislative body but require the authorization of all debt by popular vote. In most of them the decision is left to qualified voters. In at least three, however, only taxpayers are eligible to vote at such elections. The law of Florida permits the creation of debt only with the consent of two-thirds of the voters who are owners of real estate in the city.[9] Louisiana and Utah also require the approval of a majority of the taxpaying voters voting at a bond election.[10]

In the states which require a popular vote on all debts the necessary majority varies. A bare majority of those voting

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[3] Sec. 9, Ch. 252, *Laws of 1916.*

[4] Secs. 2938, 2948, *Consolidated Statutes of N. C.*

[5] Sec. 2, Ch. 206, *Laws of 1920.*

[6] *109 Ohio Laws*, pp. 342–343.

[7] *Pa. Stat., 1920*, Sec. 15723–15724.

[8] Secs. 5400–5401, *Pierce's Washington Code.*

[9] Sec. 1899, *Revised General Statutes of Florida;* utility issues require a two-thirds vote of council, the approval of the mayor and a majority vote of the people. Sec. 1925.

[10] Sec. 3, No. 46, *Laws of La. (Extra Session), 1921;* Utah Constitution, Art. XIV, Sec. 3

is the most usual requirement. Six states, however, require a two-thirds vote,[11] and five others a three-fifths vote, with certain exceptions or under certain specified circumstances. Michigan and Minnesota require a three-fifths vote for the acquisition of municipal utilities but in Minnesota villages and boroughs a five-eighths majority is required.[12] The West Virginia law requires the sanction of three-fifths of the voters for all issues and the same percentage of property taxpayers is required in Oklahoma.[13]

Three states only place the initiative in the incurring of debt directly in the hands of the people. The law of Montana provides that no debt shall be incurred unless it is authorized by the voters at an election which can be called only by petition of the qualified voters of the municipality.[14] The South Carolina law requires a majority vote of the people on all issues of bonds and the necessary election can be called only on petition of a majority of the "freeholders" of the city.[15] South Dakota towns and villages may incur debt only on petition by five-eighths of all the resident freeholders of the corporation.[16]

One state only—Indiana—makes the creation of local debt dependent upon the approval of a state authority. The significance of this requirement as a step toward administrative control of municipal indebtedness warrants more than passing notice. Vesting the power to approve local taxes and local bond issues in the State Board of Tax Commissioners was first accomplished by the Tax Law of 1919. The end sought by the passage of this law was to raise the basis of assessment from about 50 per cent of full cash value to full value. Its administration by the State Board resulted in an increase of more than 100 per cent in the taxable value of property. It was felt immediately that local officials would be able to contract large indebtedness leading to heavy future burdens, under even the low existing debt limitations. Accordingly the law of 1919 provided that

[11] California, Kentucky, Massachusetts, Missouri, New Mexico and Vermont.
[12] Michigan Constitution, VIII, 25; Sec. 1854, *General Statutes of Minnesota.*
[13] Sec. 2446, *W. Va. Code;* Sec. 575, *Revised Laws of Oklahoma.*
[14] Sec. 1, Ch. 104, *Session Laws of 1921.*
[15] Sec. 1, No. 33, *Laws of 1921.*
[16] Sec. 6413, *Revised Code of 1919.*

no local body might issue bonds without the previous consent of the State Board of Tax Commissioners. The state board was also given the right to approve increases in tax levies. The result of this legislation was to flood the State Board with requests from local bodies for the issue of loans. Considerable local opposition to the law developed and the result was the passage of a so-called "home rule" act at the special session of the legislature in 1920.

This act took away the power of the State Board over tax levies and bond issues and vested it in the County Councils.[17] This scheme failed to provide a sufficient check on local financial authorities and taxes increased to such an extent that the resulting protests led to the passage of what seems to be a definitive law, at the session of 1921.[18]

The Act of 1921 settles the matter in the following way: Any municipality may contract debt to a sum not to exceed five thousand dollars through the proper officers. Notice of determination to issue bonds in excess of this amount must be given by the legislative body by newspaper publication for at least two weeks within the taxing district. Ten or more property taxpayers in the district, if persuaded that the proposed debt is unwise or unnecessary, may file a petition with the county auditor protesting against the issue of the bonds. This petition is then certified to the State Board of Tax Commissioners and a date is fixed for a hearing in the county in which the district is located. "The decision of the State Board of Tax Commissioners upon the issuance of said obligations and the amounts thereof, if any, which may be lawfully issued, shall be final." The law further provides that the interest rate on all future obligations shall not exceed 6 per cent and that the State Board shall approve all issues where the interest rate exceeds 5 per cent.

There seems to be little difference of opinion as to the success of the present law. The State Board of Tax Commissioners,

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[17] The chief functions of the County Council in Indiana are to make appropriations and to act in an advisory capacity to the three County Commissioners who have charge of the county business.

[18] Sec. 4, Ch. 222, *Laws of 1921;* this act is an amendment of the Tax Law of 1919.

in its report for 1921, states that the taxpayers have taken advantage of the law more frequently on the question of bond issues than they have on tax levies and it is convinced "that but for the power granted the taxpayers to appeal . . . many local officers would have increased bond issues to the limit that it would take from ten to twenty years to pay."[19] It is the opinion of a qualified observer that "this plan has worked admirably in this state and the authority held by the tax board will never be taken away from them. Under it we have been able to keep down the tax levies and to defer certain public improvements which could wait to a future day."[20] The State Board has not hesitated to use its power to withhold approval of local issues as is evidenced by the fact that during the twenty-seven months prior to September, 1922, it refused its approval to 18.5 per cent of all proposed issues referred to it.[21]

The present Indiana law has features which commend it to serious students of public finance. Under it complete freedom is granted to local legislative bodies in initiating debt legislation. The determination of the city's policy as to future improvements is left where it should be placed—with the elected representatives of the people. A definite policy is thus outlined in each case and presented to the people. The protest allowed is not referable to the voters who may be misled by the importation into the issue of extraneous matters, but is presented to a body which, after hearing both sides and supplying itself with accurate information as to the community's burdens and resources, may make a decision on the merits of the case.[22]

Provisions Regarding the Term of Issue

Extended experience of investors in municipal securities has

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[19] *Report of the State Board of Tax Commissioners* for 1921, printed in the *Indiana Year Book*, 1921, pp. 894ff.

[20] Correspondence with the Legislative Reference Bureau of Indiana.

[21] Figures furnished by the Secretary of the State Board of Tax Commissioners. The Indiana experience may be followed in the annual reports of the State Board for 1919, 1920, and 1921, printed in the *Indiana Year Book* and in the statutes. The working of the Tax Law of 1919 is discussed by J. A. Estey, "Indiana Tax Reforms," in *National Municipal Review*, 9, 411–413 (July, 1920).

[22] It is interesting to note that it has recently been suggested that the mayors of Massachusetts cities and towns (other than Boston) be given sole authority to initiate loans. See *Report of the Commission on Municipal Expenditures and Taxation* (*Massachusetts House Document No. 1240*, 1923), pp. 22, 47; *Address of Governor Cox to the Legislature of 1923*, pp. 7–8.

furnished two very definite principles concerning the term for which such obligations should be issued and the method to be employed to discharge them. These principles are: First, that a direct and measurable relation exists between the character of the improvement to be financed by borrowing and the term for which the obligation representing the loan should run, and second, that real economy in the discharge of public obligations demands their repayment in regular and fairly uniform installments rather than in one payment at their maturity. These principles have reached a wider public through the retail distribution of municipal bonds. It is interesting to note to what extent these principles have been recognized in our state laws.

Of the forty-eight states thirty-eight have general laws specifying limits within which local debts must be paid or refunded.[23] These laws fall into three general classes: First, those which merely set a maximum period within which all debts must be paid;[24] second, those which prescribe various limits for different specified purposes without, apparently, correlating the purpose with the limit imposed; third, those which follow the principle that the term of the obligation should be based upon the estimated life of the improvement.

The statutory provisions of approximately two-thirds of the states fall within the first class named above. In most of these states the law grants to the cities the right to issue bonds for terms varying from fifteen to fifty years, making these limits apply, by implication at least, to debts for *all* purposes. The most usual period permitted is thirty years. The other limits most frequently met with are twenty and forty years. In only one state—Colorado—do we find a general law making debts payable in less than twenty years. Here the general limit is fifteen years.[25] Longer limits than forty years are rare and

[23] Only four states expressly forbid refunding: Georgia, Massachusetts, Louisiana and New Jersey.

[24] There are few states to which this statement would apply strictly since most of those imposing a limit allow certain exceptions. Moreover, several states, *e. g.*, South Carolina, Delaware, Maryland, Rhode Island and Connecticut, authorize many local bond issues by special acts, which differ from each other in details. The classification, however, is a valid one.

[25] Ch. 200, *Laws of 1919;* bonds of water works districts may run for twenty-five years. Sec. 6810, *Colo. Statutes;* a law of 1921 allows refunding bonds to run for thirty-five years, to be retired serially. Ch. 237, *Laws of 1921.*

are usually allowed only for definitely specified purposes. Thus Vermont has a general limit of twenty years but allows debts incurred for the acquisition of municipal forests to run for sixty years.[26] Utah limits all issues to a maturity of twenty years except those for water supply and sewerage which may run for forty years.[27] The general limit for Pennsylvania cities is thirty years, but by the constitution of the commonwealth, Philadelphia may issue bonds running fifty years for certain purposes.[28]

There is, on the whole, very little to be said in favor of setting up a blanket provision as to the maturity dates of local bonds. While such a proceeding avoids itemization, its inevitable result is to give to inefficient and badly trained officials *carte blanche* to avail themselves of the maximum limit regardless of the purpose for which the debt is created. An examination of the available records of several states shows that this is the case.

Several states while having no comprehensive law governing local debts, have provisions which stipulate certain maximum limits for specified purposes, without, however, making any special attempt to correlate the maturity limit with the purpose of the indebtedness.[29]

A small, but in recent years, growing number of states have enacted legislation based upon the principle that the obligation by which an improvement is financed should expire within the life of the improvement. The treatment of typical laws of this class is reserved for another place.[30]

The Method of Redemption

The experience of bankers and public officials has demonstrated that, in practice, the serial plan of repayment of public loans has decided advantages over the usual sinking-fund method.

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[26] No. 104, *Public Acts of 1921.*

[27] Sec. 794, *Compiled Laws of Utah,* and Ch. 19, *Laws of 1921.*

[28] *Pa. Stat., 1920,* Sec. 15723.

[29] See *e. g.*, Compiled Code of Iowa (1919), Index: Bonds, Cities and Towns, *passim;* Secs. 1852–1855, *General Statutes of Minnesota.*

[30] These states are Massachusetts, New Jersey, North Carolina, Ohio. The laws of Wyoming are also admirable.

In theory, the sinking fund for public loans has great merits; in practice, it is open to at least two objections.

In the first place, the original justification of the sinking-fund plan no longer exists. Originally public credit rested upon the accumulation and continuance of a fund out of which the debt was to be paid. It was highly important, therefore, that the "sinking" fund be maintained. At present, however, the public credit rests invariably on the taxing power and the existence of a special fund plays but a small part in the actual determination of the character of that credit.

In the second place, the statutory requirement that such funds be *provided* does not insure their *maintenance*. It is a matter of common knowledge among those interested in the subject that the failure of local authorities to maintain such funds has been the chief reason for their total abolition in those states which have recently adopted thoroughgoing programs for municipal financing. The scientific management of a sinking fund is a task requiring more skill than the average commission seems to be able to bring to it. In many cases the existence of the fund is a standing invitation to corrupt officials to dishonest manipulation of it in their own interest.[31]

The chief shortcomings in most state laws on the subject of sinking funds are that while provision is made for the creation of such funds no scientific basis is established for calculating the annual requirements and no adequate machinery has been set up for the enforcement of the laws when soundly drawn. The special investigation conducted by the New Hampshire State Tax Commission in 1916 showed that of total outstanding debts amounting to $11,665,769, $1,390,815 or nearly 12 per cent was represented by sinking-fund bonds against which no sinking funds had been established.[32] A member of the New Jersey Commission for the Survey of Municipal Financing reported that in the case of one large city in that state the

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[31] On the defects of the sinking fund plan see an excellent article by A. D. Chandler, "Amortization," in *American Economic Review*, Vol. III, pp. 875–893. A work which champions the sinking fund method is E. H. Turner, *The Repayment of Local and Other Loans* (London, 1911).

[32] *Report of a Special Investigation Relative to Municipal Finance and Accounts*, January 1, 1917, pp. 56–57.

sinking fund contained $1,250,000 in excess of its requirements; while in another city the fund had been sorely depleted by drafts made by the city department heads to eke out insufficient appropriations. In this latter case the "fund" consisted of a small tin box containing the dog-eared I.O.U.'s of various department heads—"promises" to pay to the extent of $728,000. Instances of this sort are, of course, so common as to make citation unnecessary. The theoretical merits of the sinking fund are far outweighed by the very practical difficulty of actually maintaining such funds. Such practical defects as have been mentioned have led to the almost universal preference among financiers for the serial plan of payment. Under the serial plan all danger of default and much of the danger of mismanagement is obviated by the necessity of having ready annually a portion of the principal of the loan for repayment. An added advantage is the great flexibility of the plan which makes possible a scientific division of the cost of public improvements between the present and the future. It is now in order to note to what extent our state laws make provision for the use of the two plans.

Eighteen of our states expressly permit or make mandatory the use of the serial plan of debt payment. Of this number ten make the use of this method mandatory on the subdivisions of the state. The table which follows is intended to present the pertinent facts concerning these laws.

Several features of this table require comment. In the first place the recent progress of the serial plan is evidenced by the fact that, with the single exception of California, its adoption has taken place within the past seven years; and in four states it was not made mandatory until 1921. In the second place, in the matter of the distribution of payments under the several plans considerable variety exists. The most usual provision is that repayment shall be made in "substantially equal installments" or in a given annual proportion of the whole amount. The provision requiring "substantially equal annual installments" is not to be recommended unless the date for the first payment is clearly specified, since such loose phrasing gives local officials the opportunity to postpone payment to such an

TABLE XVI.—STATUTORY MATURITY LIMITS AND SERIAL PAYMENT REQUIREMENT

STATE	MATURITY LIMIT	PURPOSES TO WHICH LIMIT AND SERIAL PLAN APPLY	DATE	REMARKS
California.....	40[1]	All.	1901. Act 2371, Gen. Laws.	Payable 1/40 each year.[2]
Colorado.....	15[3]	Rfdg.	1919–1921. Ch. 200, S. L. 1919; Ch. 237, S. L. 1921.	
Louisiana.....	40	All	1921. No. 46, Ex. Sess. 1921.	Payments beginning not later than three years from issue.
Massachusetts..	Various[4]	All	1913. Ch. 719.	Payments beginning not later than one year from issue.
Mississippi....	25	All	1920. Ch. 206.[5]	1/50 annually first five years; 1/25 next ten years; balance during last ten years.
New Hampshire	Various	All	1917. Ch. 129.	Beginning not later than two years from date of issue.
New Jersey..	Various[4]	All	1916. Ch. 252..	Beginning not later than two years from date of issue.
North Carolina	Various[4]	All	1917–1921. Secs. 2952–3, Consol Stats. N. C.	Beginning not later than three years from date of issue.
Ohio.....	Various[4]	All	1921. 109 Ohio Laws, 336.	Beginning from six to seventeen months from issue.
Vermont.....	20[6]	All	1921. Ch. 104.	Beginning not later than five years from date of issue.

[2] Fifty years maturity allowed for utilities; certain cities may issue for seventy-five years.

[3] Payments on utility debts may begin not later than ten years after issue of bonds and must be paid in installments of substantially one-fortieth of the principal sum.

[3] Refunding bonds may run for thirty-five years but first payment must be made not later than fifteen years from date of issue; bonds of water works districts may run for twenty-five years.

[4] In these states maturity limits vary with the character of the improvement.

[5] Serial payment made mandatory for bonds used to fund floating debts by *Ch. 209, Laws of 1918.*

[6] Bonds for acquiring municipal forests may run for sixty years and first payment may be deferred for thirty years.

extent as to throw the greater part of the burden on the later years of the period.[33] Certain of the states, in an attempt to distribute the payments more equitably between the present and the future, allow the installments to increase in size in the later years. Thus the North Carolina law provides that "no such installment or series shall be more than two and a half times as great as the smallest prior installments or series of the same bond issue."[34] The New Jersey law allows the later maturities to exceed the smallest prior maturity by not more than 50 per cent.[35] The same result is permitted by the Mississippi law.[36] The New Hampshire and Massachusetts laws, however, provide that the amount of the payment in any one year shall not be less than the amount of the principal payable in any subsequent year.[37] Such provisions, of course, can be looked upon only as general rules. For improvements which appreciate in value over a period of years, the greater part of the burden may well be borne by the later years; whereas those in which depreciation sets in rapidly should be paid for largely during the earlier years when the usefulness of the improvement is greatest. It is one of the very substantial advantages of the serial plan that such adjustments can be made with a great degree of exactness.

In most of the states the first series of the loan must be made

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[33] Instances of this practice are cited in the *Report of the Joint Special Committee on Municipal Finance* of the General Court of Massachusetts (*House Document No. 1803*, 1913), p. 52.

[34] Sec. 2952, *Consolidated Statutes of N. C.*

[35] Sec. 3, Ch. 252, *Laws of 1916.*

[36] Sec. 3, Ch. 206, *Laws of 1920.*

[37] New Hampshire, Sec. 2, Ch. 129, *Laws of 1917;* Massachusetts, Secs. 1, 14, Ch. 719, *Acts of 1913.*

to mature within a short time after the issue. In nearly all cases the limit is two years or less and the statute usually provides expressly for the annual collection of a tax sufficient to pay accruing interest and maturing installments. Thus, the New Hampshire law provides that the amount of each maturity and interest shall "without vote of the municipality, be annually assessed and collected." The Ohio act provides that the County Auditor shall enforce inclusion of such charges in the annual local budget.[38] In Massachusetts determination of the annual requirements is left in the hands of local authorities and raised by the assessors.[39] In New Jersey a central authority certifies to the local government the requirement and his calculation must be accepted and included in the budget.[40] For the most part, therefore, enforcement of this feature of the laws is in the hands of local officials.

State Registration of Local Debt Statistics

The possession by the state of complete and accurate information concerning the amount and character of local indebtedness is of prime importance. Of the forty-eight states, nineteen make some provision for the registration with state authority pertaining to local indebtedness. There is considerable variety in these provisions, their character ranging all the way from the simple requirement that the state authorities shall be periodically notified concerning local debts to provisions making such registration precedent to the creation and validation of debts. The laws in these nineteen states fall roughly into the following classes:

First, those requiring simply that the data on local debts shall be periodically reported to a state official or board, such statutes apparently not contemplating more than a complete record of such debts. In a few cases the required reports are

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[38] As a member of the County Budget Commission (created in 1911) it is the duty of the County Auditor to present the budgets of all local governments in the county. This arrangement was originally adopted as a means of seeing that the tax limits imposed by the Smith Law were not exceeded.

[39] Secs. 1, 8, Ch. 719, *Acts of 1913.*

[40] Subsec. (f), Sec. 12, Ch. 192, *Laws of 1917* (*Budget Act*).

filed with a county officer and by him certified to the central authority. This class of laws is illustrated by the California Act of 1872 which requires that the city clerk shall notify the State Board of Control (now the Department of Finance) of the purpose, amount, date, denomination, interest, etc., of each issue of bonds and furnish at the same time information concerning the assessed value of taxable property in the city and the total outstanding debt. Such information, however, is merely for record and no use of it is made in the positive supervision of local indebtedness.[41] Similar reports are required in Connecticut, Indiana, Iowa, Kansas, Mississippi, North Carolina, Texas and West Virginia.[42] The provisions of the other laws in this general class differ from those mentioned already only in that the required report is first made to a county official (usually the Auditor) and by him certified to the proper state authority. This practice is true in Idaho where the data are sent to the Auditor of State; in Pennsylvania where they are filed with the court of Quarter Sessions; and in Wisconsin where the county clerk collects the figures and turns them over to the State Tax Commission.[43]

The law of at least two states requires registration as a means of placing in the hands of central authorities some measure of control over the redemption of local debts. The law of Missouri requires annual reports by county and city clerks to the State Auditor concerning new issues and those redeemed during the year. On the basis of these reports the Auditor certifies annually

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[41] *California Statutes*, 1911, p. 595; 1921, p. 1028. These data are published annually by the State Controller under the title: *Financial Transactions of Municipalities and Counties.*

[42] Sec. 1256, *General Statutes of Connecticut;* see also *Quadrennial Report of Expenditures and Indebtedness of Municipalities*, published by the State Tax Commissioner, to whom debt reports are made, 1920; Sec. 2, Ch. 54, *Indiana Laws of 1919*, requires compilation of such data to be made by the Legislative Reference Bureau; Secs. 127, 3662, 4359, *Iowa Compiled Code* (1919); Sec. 10723, *General Statutes of Kansas;* Sec. 1, Ch. 133, *Mississippi Laws of 1912;* Ch. 92, *North Carolina Laws of 1919;* Arts. 619–620, 699, *Revised Civil Statutes of Texas* (1911); Secs. 279–287, *West Virginia Code* (1913). In North Carolina reports are made to the Department of Revenue; in Connecticut and West Virginia, to the State Tax Commissioner; in the other states they are made to the State Auditor or Controller.

[43] Ch. 171, *Session Laws of Idaho*, 1921; *Pa. Stats.*, 1920, Sec. 15723; Ch. 515, *Wisconsin Laws of 1917;* in Wisconsin these data are published annually by the State Tax Commission and certain financial data are brought out in monthly bulletins of the Commission.

to the subdivision the amount required to pay interest and maturing bonds. This amount is collected as a part of the state taxes levied in the municipality and paid to the local authorities.[44] A somewhat similar plan is prescribed in Nebraska except that the taxes for interest and redemption are levied by the county board of commissioners.[45] It is a distinctive feature of the New Jersey scheme for local financing that these requirements are certified by a state authority and his certification constitutes a mandatory item in the annual budget of the municipality.[46]

Finally, a few states require registration as a part of the scheme of state validation of municipal bond issues. The laws of Colorado require that the Auditor of State shall register all bonds on receipt of the order of the local governing body authorizing their issue and provide that such registration shall constitute conclusive evidence of legality as against any claim made on behalf of the issuing corporation.[47] Registration with the Director of Accounts is required by the Massachusetts laws and the Director has powers over certain classes of local obligations which practically amount to validation.[48]

The data presented indicate that nearly two-thirds of our states have made no provision for the systematic collection of the facts concerning the debts of their minor subdivisions. It is true that in those states which have developed an efficient system for the inspection of local accounts, considerable material is available for those in a position to have access to it; such material, however, has nowhere near the value which would attach to records systematically compiled for the single purpose of affording up-to-date information on the subject.[49]

The advantage of having an accurate record of local bonded

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[44] Sec. 7762, *Revised Statutes of Missouri* (1919).

[45] Secs. 391–392, *Revised Statutes of Nebraska.*

[46] Chs. 154, 155, 156, *Laws of 1917* and Ch. 266, *Laws of 1918.*

[47] Sec. 6692, *Colorado Statutes.*

[48] Ch. 23, *Acts of 1919;* Ch. 719, *Acts of 1913.*

[49] The Auditor of the State of Ohio, who is *ex officio* Chief Inspector and Supervisor of Public Offices in 1916 and 1918 published valuable Comparative Debt Statements covering the financial affairs of each subdivision of the state. Much interesting material is also contained in the annual reports of the same official in his capacity as Auditor. Similar figures are also published in Iowa, Massachusetts and New Jersey, and occasionally in other states. Those cited, however, are the most satisfactory.

debt would be threefold. In the first place, it would be of considerable value to the investor to have constantly available accurate statistics on the volume and character of local obligations. At present such figures are available in certain unofficial publications but they are too often set forth apart from the many related facts upon which in practice they depend for their true significance. It can scarcely be doubted that only the state has at its command the resources necessary to compile such data with authoritative fulness and accuracy.

In the second place, the existence of such a volume of reliable facts would be of inestimable value to the state itself as a guide in its policy toward the financial practices of its subordinate governments. Few states, indeed, it would appear, have founded their policies, such as they are, on a solid basis of fact. So long as the states, however, assert their supremacy over local affairs there will continue a growing need for a factual basis upon which to make good this assertion. Government is not an affair of opposing and jangling units, but a co-operative enterprise in which obligations as well as rights rest upon the legally predominant partner. Assertion of this predominance as a mere *legal* right is to deny the singleness of the problem of government. The power which undeniably dwells in the *machinery* of government has its uses and not the least of these is the opportunity it gives for the organization of the intelligence of the community.

Moreover, the central collection of such data would redound to the benefit of the taxpayer. In a state containing scores and even hundreds of governmental units with power to incur debt, the credit of all but the largest depends in no small degree upon the character of the financial practices of perhaps the smallest. The credit of every community could be kept at a higher level if investors had at their disposal, at trifling cost, the exact facts as to the existing burdens and resources of every community in the commonwealth. No small part of the cost of issuing public obligations is traceable to the expense of collecting such facts and this expense is borne by the taxpayer in higher interest rates. This additional burden might be measurably reduced if every legislative body knew that its

own record of debt administration was common knowledge among those who furnish the cash.

Provisions for State Validation

The tangle of legislation regarding the incurring of debt which exists in most states makes the problem of passing on the legality of issues a difficult and expensive one. The average local government cannot afford legal talent competent to pass upon the intricate questions which arise with every issue of bonds. Unless there is a public authority clothed with ample power to make a final decision as to the legality of a debt, the average city finds itself at the mercy of the bond house whose charges may be governed rather by the severity of competition than by the inherent difficulty of the specific problem. That the expenses connected with the validation of municipal bonds are not trifling admits of no doubt.[50] Where statutory provisions are particularly confused these difficulties are aggravated. The present legislation under which New Jersey municipalities operate replaced more than a thousand general and special laws on the subject.[51] The Ohio Bond Act of 1921 specifically repealed some twenty-five sections of the General Code and by implication many others which were the fruit of many years of piecemeal legislation on the subject.[52] The situation in Massachusetts before the Municipal Finance Act of 1913 was similar.[53]

The statutory provisions for the state validation of local debts fall into three classes. In a few states the duty falls upon the Attorney-General. Validation may be either compulsory or the services of the Attorney-General may be called for at the option of the legislative body. North Dakota, Oklahoma and Wyoming make provision for validation in their constitu-

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[50] This fact is recognized by the law of S. D. which places a limit on expenses for such purposes; see Sec. 6416–6419, *Revised Code of S.D. Cf. Report of (La.) Supervisor of Public Accounts*, 1919–1920, pp. 6–7.

[51] *Report of the Commission for the Survey of Municipal Financing*, pp. 5–7.

[52] 109 *Ohio Laws*, pp. 336ff. Correspondence with Hon. R. R. Beetham, Speaker of the House of Representatives, and Hon. H. H. Griswold, author of the Bond Act of 1921.

[53] See C. F. Gettemy, "The New Massachusetts Legislation Regulating Municipal Indebtedness," in *National Municipal Review*, Vol. III, 682–692 (October, 1914).

tions—the validating officer being the Attorney-General in the two states first mentioned. The law of Texas requires the presentation of all bonds before sale to the Attorney-General, together with a record of proceedings. His validation makes such obligations incontestable except for fraud, forgery or excess of the constitutional debt limit.[54] A recent Wisconsin law makes the Attorney-General *ex officio* Bond Commissioner. His certification of bond issues constitutes a bar to all suits except upon constitutional grounds, unless brought within thirty days after the recording of his opinion. The use of the Bond Commissioner's services is optional with the local governing body and first-class cities are permitted to employ their own bond attorney.[55]

A second group of states provide for validation by means of court procedure. In Florida proceedings to test the legality of issues must take the form of a suit in equity against the state in the Circuit Court. A favorable decision by the court makes the bonds incontestable. Appeals may be taken to the Supreme Court.[56] In Georgia issues are passed on by the Superior Court on suit by the Solicitor- or Attorney-General against the city or on petition by the city itself. The decision of the court if favorable, validates the bonds.[57] In Missouri approval is given by the Circuit Judge. His decision, together with registration with, and certification by, the State Auditor, makes all bonds incontestable except on grounds of fraud, forgery and excess of the constitutional debt limit.[58] In New York validation is performed at the request of the city by the Supreme Court.[59]

In West Virginia is found a combination of the two methods just discussed. In that state the Attorney-General in the first instance renders an opinion as to the legality of a local issue

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[54] Arts. 619–625, *Revised Civil Statutes of Texas* (1911).
[55] Sec. 3, Ch. 576, *Laws of 1921.*
[56] Secs. 3296–3297, *Revised General Statutes of Florida.*
[57] Secs. 445–461, *Code of Georgia* (1911), and No. 396, *Laws of 1920.*
[58] Secs. 1063–1065, *Rev. Stats. of Mo.* (1919), and *Laws of 1919*, pp. 175, 180.
[59] Secs. 22–29, Art. II-a, Ch. XXIV, *Consol. Laws of N. Y.*

Appeal may be taken from his decision to the Supreme Court of the state whose decision is final.[60]

So far as the writer has been able to determine only one state has created an independent officer charged solely with the duty of validating local bond issues. A Mississippi law of 1917 provides the following scheme: The Supreme Court is directed to appoint a State's Bond Attorney who shall have the same qualifications as the Attorney-General. The proceedings in local bond issues are submitted to the Bond Attorney who then files his opinion as to the legality of the proposed issue with the clerk of the Chancery Court in the proper county. A hearing may be demanded by any person in interest, at which the Bond Attorney must be present. At the conclusion of the hearing the Judge of the Chancery Court enters an order in accordance with his findings. This order, if favorable, validates the issue. Appeal is allowed to the Supreme Court. The procedure outlined by this law, while not mandatory upon local authorities, seems to be much resorted to in practice, and the law has become popular especially in small communities, where securities are as a rule disposed of locally.[61]

No general statement is possible regarding the validation process in the other states. A tendency seems to be indicated by recent laws, however, to determine questions of legality as nearly as possible coincident with the actual issue of bonds. For example, the Louisiana Bond Act of 1921 provides as follows: "The resolution authorizing the bonds may direct that they shall contain the following recital: 'It is certified that this bond is authorized by and is issued in conformity with the requirements of the constitution and statutes of this state.'" The act provides that this recital shall be taken to mean that all the proceedings taken in the issue of the bonds have been regular and legal, that the debt limit has not been exceeded and that the law has been complied with in all the details surrounding their issue.[62] This tendency is further illustrated by

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[60] Ch. 57, *West Va. Acts of 1917.*

[61] Ch. 28, *Extra Session of 1917.* The duties of the Massachusetts Director of Accounts are reserved for discussion in Chapter IV.

[62] No. 46, *Extra Session of 1921*, p. 49f.

the provisions of the North Carolina Municipal Finance Act of 1917–1921 and by the New Jersey Bond Act of 1916.[63]

A cheap and expeditious method of validating bond issues is much to be desired in the interest of the taxpayer upon whom the cost of unofficial validation must always fall. It is perhaps true, that on the whole, most of the plans set forth above are reasonably effective. In view of the fact that our courts have never yet framed a satisfactory definition of debt, the determination of this question will no doubt continue to be a matter for semi-judicial action. Whether it is wise, however, to place this work in the hands of the courts, crowded as their dockets are with other business, is doubtful. The questions involved in the creation of debt are legal only in part. Most of them are at base economic. It would seem reasonable, therefore, to combine the functions of legal validation and the supervision of the more purely economic phases of debt creation and redemption in the hands of an authority specifically charged with the general oversight of debt-creation viewed as a financial device. Legal validation at best protects taxpayers and investors only against the *unusual* thing—default or excess of the debt limit. The wisdom or unwisdom of the loan, traced in the provisions made for its repayment, are equally fit subjects for supervision, and these matters court action and other methods of legal validation do not touch.

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[63] The North Carolina Municipal Finance Act was first passed in 1917. It was amended and re-enacted in 1921 and appears as *Sections 2918 to 2961*, inclusive, in the Consolidated Statutes. The New Jersey provision is Sec. 2, 10, of Ch. 252, *Laws of 1916*.

IV

Recent Programs for Local Debt Supervision

The preceding chapters have demonstrated that up to the present the policy of our states toward the question of local debts has produced little beyond a hodge-podge of legislation through which the student searches in vain for any informing principle. Changes in laws made necessary by the increase in local functions have been made apparently without reference to preceding laws and without adherence to any settled policy. Here and there, in our review of the statutes we have lighted upon provisions which embody what financiers and forward-looking officials have come to look upon as sound principles in the financing of local improvements; but the occurrence of such provisions seems largely accidental and they are seldom present in such combination as to constitute a comprehensive program. The elements involved in the question of public debt are so interdependent that piecemeal treatment of the subject is likely ultimately to be disappointing in its results. It is the purpose of this chapter to discuss recent legislation in two states where the problem has been viewed as a whole and a sound program adopted for its solution.

Massachusetts Debt Legislation

The pioneer in the field of scientific regulation was the state of Massachusetts. This state, by a series of laws enacted since 1910, and based upon thorough investigation and tested by actual experience, has, during the last decade, constructed the most advanced local financing program to be found in the United States—a successful experiment in fiscal legislation which has served as a model for similar laws in other states. This group of laws was aimed at four specific abuses which investigation showed were more or less general in Massachusetts cities and towns.[1] These abuses were: (1) Borrowing for current

[1] It should be pointed out here that none of this legislation applies to Boston. The Municipal Indebtedness Act was originally passed in 1913.

needs; (2) unrestricted borrowing in anticipation of tax collections; (3) the diversion of trust funds and the incurring of other liabilities without providing properly for their payment; (4) the inefficient management of sinking funds.

Prior to 1913 the creation of funded debt by Massachusetts cities and towns was regulated by a law of 1875 which, after specifying certain legitimate purposes for which funded debt might be incurred, provided that debt incurred for any other purpose must be repaid within ten years.[2] This loose phrasing of the law made easy the inference by local officials that borrowing for *any* purpose was permissible so long as the loan was made payable within ten years. An investigation made by the Bureau of Statistics[3] in 1912 showed that fixed debt had been rather freely created for purposes which could properly be called "current expenses" even under a loose interpretation of that term.[4] In spite of the fact, however, that the law of 1875 permitted an extremely free definition of the term "current expenses" at the same time it pointed the way to the remedy of this abuse. For the act of 1913[5] put an end to such borrowing by the simple expedient of extending the list of legitimate purposes and periods for which debt might be contracted and then prohibiting unconditionally borrowing for any other purpose.[6]

Under the law as it stood prior to 1913 borrowing by cities and towns in anticipation of revenues was permitted subject to the condition that such loans be paid within a year after their contraction. The statutes contained no limitation on the amount which might be borrowed on temporary notes although it seems obvious that the legislature meant to restrict it to a

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[2] Secs. 6, 7, 8, 11, Ch. 209, *Acts of 1875*.

[3] Under the Massachusetts Consolidation Act of 1919, the Bureau of Statistics became the Division of Accounts in the Department of Corporations and Taxation. Secs. 52–54, Ch. 350, *Acts of 1919*.

[4] See p. 15 of *Report of a Special Investigation Relative to the Indebtedness of the Cities and Towns of the Commonwealth, by the Bureau of Statistics, House Document No. 2168*, 1912, for a list of these purposes. An additional abuse was the use of demand notes in temporary borrowing. This latter practice was stopped by Ch. 45, *Acts of 1912*, by which the Director of the Bureau of Statistics was prohibited to certify demand notes. In 1912 there were demand notes to the amount of $1,600,000 outstanding. See p. 13 of the report first cited in this note.

[5] Ch. 719, *Acts of 1913*.

[6] See *Fifth Annual Report of the Statistics of Municipal Finance*, Bureau of Statistics, 1913, p. ix.

figure well within the prospective revenues of the year. Investigation showed, however, that in many cases loans had been made in excess of actual tax collections, necessitating in some cases renewal or refunding, which placed the date of actual cancellation far beyond the limit intended by the law.[7] This was equivalent, of course, to borrowing for current needs and was none the less vicious because it was done without direct violation of the letter of the statutes. Moreover, while the old law authorized these temporary loans to be made only in anticipation of taxes, the term "taxes" was often given a very liberal interpretation and made to include revenue of all sorts. The new legislation recognized the weakness of this practice and limited temporary loans to the amount of the actual collections of the previous year, including the city's share of the bank, corporation and street railways taxes.[8]

Between the date of the first investigation of municipal finances by the Bureau of Statistics and the close of the legislature of 1913, permission had been granted in the cases of thirty-two cities and towns to refund by the serial method of payment, indebtedness aggregating $1,125,243 most of which represented liabilities caused by the borrowing or use of trust funds, demand notes long outstanding and other debts for the payment of which proper provision had not been made at the time of their incurrence.[9] The legislation required that such obligations be

[7] The special investigation of city and town indebtedness conducted by the Bureau of Statistics in 1912 showed that of total tax loans for the fiscal year 1910 incurred by the 71 towns of the state with a population exceeding 5,000 amounting to $6,011,415, $1,749,785 or 28.9 per cent were outstanding at the close of the year. The dangerous nature of the practice of borrowing up to 100 per cent of the anticipated *revenues* is shown by the fact that although the tax warrants of these same towns amounted to $11,505,296, $2,026,465 or 17.6 per cent remained uncollected at the close of the year; see *Report of Special Investigation*, etc. (House Document No. 2168, 1912), pp. 30, 56–57; for towns under 5,000 population, *ibid.*, pp. 84–85.

[8] Secs. 3, 4, Ch. 719, *Acts of 1913; Fifth Annual Report on the Statistics of Municipal Finance*, p. x.

[9] There is an interesting discussion of the extent of the use of demand notes in local financing in Massachusetts in *Third Annual Report on the Statistics of Municipal Finance*, pp. xvii–xx. The investigation of the New Hampshire Tax Commission, quoted elsewhere in this study, showed a rather extensive use of such paper among the local governments of that state also. The following figures on miscellaneous debts in Massachusetts cities and towns of the character referred to in the text are of interest:

Loans for individuals and banks obtained chiefly on demand notes	$ 296,694.22
Principal of trust funds borrowed	460,171.88
Cemetery funds used	390,568.88
Total	$1,120,434.98

paid out of taxes to be collected during 1914 unless such action would cause the tax levy to be unnecessarily heavy. In the latter event cities and towns were authorized to fund such debts in bonds whose maturity date must not fall later than fifteen years from their issue.[10]

The Massachusetts legislation of 1913 in so far as it dealt with provisions for the repayment of local debts was based squarely upon the demonstrated fact that in practice the sinking fund plan had broken down. One of the investigations which preceded legislative action dealt solely with the practical administration of such funds. The Director of the Bureau of Statistics, in charge of this investigation, summarizes its results as follows:

> "It was found, upon computing some 1,200 different sinking funds in the 85 Massachusetts cities and towns having such funds, that while 47 showed net surpluses aggregating $2,855,192, there were 52 instances in 40 different municipalities of apparent failure to provide sufficiently for the requirements of the funds . . . the deficiencies according to the method of computation adopted, aggregating $1,794,391. In numerous cases the contributions were based upon no definite, regular formula, the amounts which should have been raised annually having apparently never been properly calculated, or not recalculated with sufficient frequency to meet current requirements accurately.[11]

The legislation based on this report and on the results of an independent investigation conducted by a special joint committee of the General Court struck at the evils of sinking-fund administration by forbidding for the future the issue of term bonds by local subdivisions and requiring sinking funds already in existence to be put on a sound basis.[12] The result of this law in the

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These figures were compiled in 1913 and refer to 15 cities and 67 towns out of 156 whose accounts were examined. The Director of the Bureau of Statistics estimated that the total outstanding indebtedness of this character in the state would be approximately $1,648,000. See *Report of Outstanding Indebtedness of Certain Cities and Towns of Massachusetts* (Senate Document No. 373, 1913), p. 3.

[10] Ch. 634, *Acts of 1913*. The most recent reports of the Division of Accounts show that the total of outstanding loans for the repayment of trust funds used is less than $10,000 for all the cities of the state.

[11] *Report of a Special Investigation Relative to the Sinking Funds and Serial Loans of the Cities and Towns of the Commonwealth* (House Document No. 2162, 1913), p. 17.

[12] The serial method was recognized by existing laws, but was not mandatory. Most of the 33 cities of the state and many of the towns, however, made use of both methods.

steady substitution of the serial for the sinking-fund plan is shown in the tables below.

The foregoing paragraphs summarize briefly those features of the legislation which were aimed at specific abuses. These features, however, form only a part of the entire program which enacted many constructive ideas in the field of municipal finance.

TABLES XVII, XVIII AND XIX.—METHOD OF MEETING DEBT REQUIREMENTS IN MASSACHUSETTS CITIES AND TOWNS, 1910–1920[13]

Cities

YEAR	PER CENT SERIAL	PER CENT SINKING FUND	PER CENT TO STATE SINKING FUNDS[14]
1910.....	31.96	54.03	14.01
1912.....	42.60	44.10	13.30
1914.....	52.70	40.50	6.80
1916.....	61.40	32.40	6.20
1918.....	70.50	23.70	5.80
1920.....	74.80	19.50	5.70

Towns Over 5,000 Population

1910.....	81.19	11.72	7.09
1912.....	84.50	9.60	5.90
1914.....	87.10	8.70	4.20
1916.....	89.00	6.30	4.70
1918.....	89.10	5.40	5.50
1920.....	90.50	4.20	5.30

Towns Under 5,000 Population

1910.....	86.50	9.09	4.41
1912.....	90.50	6.60	2.90
1914.....	92.80	6.30	0.90
1916.....	94.30	4.80	0.90
1918.....	95.50	3.90	0.60
1920.....	96.30	3.30	0.40

Reference was made above to the fact that borrowing for current expenses was stopped by adding to the list of legitimate purposes and forbidding loans for any other purpose. In making such

[13] Compiled from the *Reports on the Statistics of Municipal Finance*, 1910 to 1920.

[14] Sinking and loan fund payments made to the state on account of abolition of grade crossings and metropolitan sewer, park and water systems.

additions the Massachusetts legislators gave recognition to the principle that bonds should not be issued for a term greater than the life of the improvement. The loans authorized by the law fall into two general classes, namely, those within the 2½ per cent limit fixed for cities, and 3 per cent for towns, and those which are exempt from those limits. So important has been the Massachusetts act as a precedent for future legislation that the provisions on this point are given in the table which follows:

TABLE XX.—PURPOSES AND MATURITY LIMITS OF MUNICIPAL BONDS UNDER MASSACHUSETTS LAW

PURPOSE	TERM OF BONDS
Construction of sewers	30 years
Acquisition of land for parks	30 "
Acquisition of land for general purposes	20 "
Construction of and additions to school and other buildings	20 "
Construction of iron, stone, or concrete buildings	20 "
Original construction, widening or extension of streets	10 "
Construction of stone, brick or other permanent pavements	10 "
Construction of macadam pavements	5 "
Purchase of land for cemeteries	10 "
Additional departmental equipment	5 "
Construction of sidewalks	5 "
Connecting dwellings with sewers	5 "
Abolition of nuisances	5 "
Extreme emergency appropriations involving public health or safety	5 "
Payment of final judgments after tax rate has been fixed[1]	1 year
Other emergency appropriations if approved by state authority[2]	1 "

[1] Added by *Ch. 114, Acts of 1920.*

[2] Added by *Ch. 591, Acts of 1920.* Such loans must receive the approval of a board composed of the attorney-general, the state treasurer and the director of accounts.

TABLE XXI.—PURPOSES FOR WHICH MASSACHUSETTS CITIES AND TOWNS MAY BECOME INDEBTED OUTSIDE THE STATUTORY DEBT LIMIT[1]

PURPOSE	TERM OF BONDS
Temporary loans	1 year
Water supply	30 years
Extension of water mains and water department equipment	5 "
Gas or electric plants[2]	20 "
Land for public playgrounds[3]	30 "

[1] Debts for these purposes as well as those within the debt limit may be contracted only with the approval of two-thirds of those voting at a special election. The laws regulating municipal indebtedness constitute Chapter 44 of the General Laws; they have been issued by the Division of Accounts as *Municipal Bulletin No. 9*, November, 1921.

[2] Indebtedness for this purpose not to exceed 5 per cent of the assessed valuation in towns and 2½ per cent in cities.

[3] Limited to ½ of 1 per cent of the assessed valuation.

In connection with the debt limits imposed by this act it is to be noted that there is nothing in the constitution of Massachusetts to prevent the legislature from exempting loans for certain purposes from the debt limit by special act. The ease with which such special acts were secured prior to 1913 was one of the evils of the former state of affairs. "Heretofore the legislature has generally had before it only the *ex parte* testimony of interested local officials whose statistics and statements in support of their supposed necessities it has been nobody's particular business to examine critically and which, in the absence of reliable, exact information, could not readily be refuted."[15] An act of the legislature could not, of course, present such legislation in the future, but coincident with the passage of the act relating to municipal indebtedness, the practice was made more difficult by an act which provided that the director of the Bureau of Statistics should examine all petitions for special treatment and report thereon to the legislative committee to which such petition had been referred. Thus the legislature has the benefit, before taking final action on such petitions, of the impartial opinion of a state authority well equipped to learn and pass upon local financial needs.[16]

An integral part of the Massachusetts scheme for the control of local indebtedness is the work of the Division of Accounts, originally the Bureau of Statistics. The activity of this Bureau in collecting statistics on local finances furnished the groundwork for the more prominent features of the program. The collection of such information was, by an act of 1906 entrusted to the Bureau of Labor Statistics.[17] Three years later, on the

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[15] *Fifth Annual Report on the Statistics of Municipal Finance*, pp. xii–xiv.

[16] Special treatment has continued to be necessary in many cases. The Director of Accounts in his most recent annual report—the 15th— says: "The changes in the laws of taxation, which have materially affected local valuations of taxable property, have actually reduced the borrowing capacity, and, . . . a general law should be passed to increase the debt limit so as to offset this loss. This would eliminate to a great extent the special acts which are passed each year." The Director also suggests that certain "restrictions be placed on the filing of bills for legislation authorizing municipalities to borrow outside the debt limit by requiring that the subject matter of proposed bills be first submitted to the voters . . . and that no bill be considered by the legislature unless a majority of the registered voters favor such legislation." See Report, p. x. The same recommendations are made in the *Report of the Commission on Municipal Expenditures and Taxation* (House Document No. 1240, February, 1923), pp. 9, 18, 46.

creation of a separate and independent Bureau of Statistics the work was transferred to the new bureau. This latter bureau preserved an independent existence until the Consolidation Act of 1919 which made it a division in the Department of Corporations and Taxation.

An act of 1909[18] made it the duty of the accounting officer of each city and town to report to the Director of the Bureau of Statistics, on blank forms furnished by the latter, the details of the financial transactions of the municipality for the last fiscal year, a statement "of the public debt showing the purpose for which each item of the debt was created and the provision made for the payment thereof," and a statement of assets and liabilities at the close of the fiscal year. In the following year it was made the duty of town accountants to keep their accounts in conformity with the classification and forms prescribed by the Director of the Bureau.[19] The powers of the Director were extended by another act of the same year which gave him power to audit accounts of cities and towns on petition for such audit by the town meeting or the city council and to install a system of accounts on petition from the same authority. The same act provided further that the Director's report of his findings should be "accompanied by such suggestions as he may deem advisable for the proper administration of the city or town finances."[20]

While the acts reviewed above imposed increasing duties upon the Bureau of Statistics they resulted in the collection of data of inestimable value as a basis for those features of the program which deal specifically with the question of indebtedness. They were, moreover, the cause for the building up of an efficient investigating force. No agency existed in the commonwealth so well equipped for the investigations preliminary to

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[17] Ch. 296, *Acts of 1906*.

[18] Ch. 371, *Acts of 1909*.

[19] Sec. 3, Ch. 624, *Acts of 1910*.

[20] Ch. 598, *Acts of 1910*, amended by Ch. 706, *Acts of 1913* so as to facilitate the establishment of a uniform system of accounts. Ch. 159, *Acts of 1917* extends the operation of the act to water, light, watch and improvement districts. By Ch. 245, *Acts of 1920*, the accounts of all subdivisions of the state are required to be audited at least once in every three years. Compulsory acceptance of a uniform accounting system has not yet been provided although many towns have voluntarily accepted systems installed by the state authorities.

the legislation of 1913. In the years that have intervened since its creation the bureau has been able to perfect its debt records which are constantly consulted by prospective investors in Massachusetts municipal loans.

The contact with local officials necessitated by the collection of these data has created in both state and local officials a view of the relationship between the municipality and the commonwealth which is a truly distinctive feature of the whole Massachusetts program. The principle of home rule has been observed inviolably and few attempts have been made to force unwelcome or "advanced" legislation upon local communities. The fruit of this policy of co-operation as distinct from compulsory legislation may be followed in the annual reports of the Bureau of Statistics since the passage of the original municipal indebtedness legislation. The services of the bureau have been sought in increasing volume each year and the routine work of auditing, inspecting and advising has grown steadily from year to year.[21] Moreover, the public opinion which stood back of the original legislation has continued to support it and with the exception of minor changes, shown by experience to be desirable, the main outlines of the program remain unchanged.

The Certification of Town Notes

It is evident from what has been said that the Massachusetts legislation did not contemplate rigid control of local finances by state administrative authority endowed with mandatory powers.[22] In its essentials the supervision provided is legislative in character and depends for its efficacy upon the degree of public sentiment and official co-operation secured in its behalf by the

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[21] See especially annual reports for 1909, 1912 and 1920. This feature of the program is favorably commented on in the *Report of the Commission on Municipal Expenditures and Taxation*, which reported to the General Court of 1923 (House Document No. 1240, 1923), pp. 12, 15–16.

[22] It is true, however, that the draught of a proposed law appended to the *Report of a Special Investigation Relative to the Indebtedness of the Cities and Towns of the Commonwealth*, contained a provision creating a Board of Municipal Loans to be composed of the Director of the Bureau of Statistics, the Tax Commissioner and the Treasurer and Receiver-General *ex officiis*. This proposed board was to have authority to approve or disapprove all loans for purposes not specifically provided for in the other sections of the act. This section, however, was not incorporated in the original indebtedness act.

campaign which produced it, and the attitude of the central authorities entrusted with the enforcement of the acts. To this general statement there is one important exception, namely, the legislation providing for state certification of town notes.[23]

The first legislation relating to this subject was passed in 1910 and became effective the next year. An "Act relative to the form of notes to be issued by towns for money borrowed" required town treasurers to issue notes only on forms supplied by the Director of the Bureau of Statistics and to send such notes, signed by himself and countersigned by a majority of the selectmen, to the Director. The latter, if he should find them duly issued, was to attach his certificate to that effect and return them to the town treasurer. The payment of all notes, whether issued before or after the passage of the act was required to be reported to the Director. By an amendment to the original act, passed in 1912, it was provided that the Director "shall not certify any note as provided in this act if it shall appear that the provisions of law relating to municipal indebtedness in the making of said note have not been properly complied with."[24]

At the time of the passage of this legislation a feeling was prevalent in some quarters that towns would resort more generally to issues of bonds when borrowing for other than revenue purposes, to avoid subjecting such loans to certification. This feeling, however, was not justified by the results of the act and each year since its passage has witnessed an increase in the number of notes issued as compared with bonds. In fact, many towns now issue notes to the exclusion of bonds, even for long-term borrowing, in order to take advantage of the act.[25] There can be little doubt either as to the genuine popularity of the procedure prescribed by this legislation or of the beneficial

[23] It is to be noted that this legislation applies only to *town notes*. City notes and bonds and town bonds are exempted from its provisions. The giving of a series of notes instead of bonds is quite popular in Massachusetts communities and has the advantage from the town's point of view, of saving the expense of engraving and printing bonds.

[24] Ch. 45, *Acts of 1912*. The exact procedure followed in the certification of notes is described by the Director in the *Third Annual Report on the Statistics of Municipal Finance*, p. xvi.

[25] The favorable attitude of both town officials and investors may be found described in *Third Annual Report on the Statistics of Municipal Finance*, p. xvii; 4th *ibid.*, p. xv; 5th *ibid.*, p. vii. Correspondence with R. L. Day & Company, investment bankers, Boston.

results which have accrued to the standing of such securities. This improved standing is due to the fact that certification is, in effect, a guarantee of the genuineness of the note and creates a strong presumption in favor of its legality, since the Director is required to withhold his signature if, in his judgment, the statutes relating to municipal indebtedness have not been complied with.

TABLE XXII.—CERTIFICATION OF TOWN AND DISTRICT NOTES IN MASSACHUSETTS, 1911–1292.[1]
(000's OMITTED)

	REVENUE AND OTHER TEMPORARY LOANS		GENERAL LOANS		TOTAL	
YEAR	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT
1911.....	983	$ 8,974	433	$ 737	1416	$ 9,711
1912.....	1,093	9,438	831	11,093	1924	10,532
1913.....	1,241	10,958	1095	1,727	2336	12,685
1914.....	1,411	12,780	1290	1,779	2701	14,560
1915.....	1,501	13,857	1306	1,505	2807	15,363
1916.....	1,437	14,066	867	1,204	2304	15,270
1917.....	1,456	15,414	809	819	2265	16,234
1918.....	1,665	16,434	664	711	2329	17,145
1919.....	1,483	16,914	912	1,682	2395	18,597
1920.....	1,802	20,990	1339	1,869	3141	22,859
1921.....	2,176	25,695	1923	2,390	4099	28,085
1922[2].....	1,891	24,451	1488	1,822	3379	26,273

[1] *15th Annual Report on the Statistics of Municipal Finance*, for fiscal years ending betwee November 30, 1920 and March 31, 1921.
[2] To October 1, 1922.

In summarizing, the Massachusetts laws on the subject of municipal indebtedness are seen to embody the following features: (1) Borrowing for current expenses is forbidden and effectively ended not only by the statutory prohibition but by the creation of a state official who must refuse certification of notes issued for such purposes by towns and whose records of the indebtedness of all local governments, being open to inspection by investors, constitute a bar to such financing even in the case of loans over which he has *legally* no control.

(2) Temporary borrowing in anticipation of taxes is placed

on a scientific basis by (*a*) limiting the amount of such loans to the taxes actually collected during the preceding year; (*b*) by requiring such loans to be repaid within a year and making it the duty of local officials in towns to report such repayment to a state authority; (*c*) by requiring certification of such notes by a central authority.

(3) The legislation relating to funded indebtedness recognizes the principle that debts incurred for municipal purposes should be repaid within the period of the usefulness of the improvement contemplated.

(4) By making mandatory the serial method of redemption this legislation (*a*) abolished the administrative difficulties inseparable from the management of the sinking fund, and (*b*) it places (or allows the placing) upon the present generation, where it usually belongs, a large share of the cost of capital improvements.

(5) The notes of the 316 towns in the commonwealth are issued subject to certification by the Director of Accounts, a procedure which is, in effect, a guarantee of legality. This has had the effect of materially improving the investment standing of this type of municipal securities.

(6) The auditing function of the Division of Accounts has been an integral and invaluable part in the practical administration of the program. The collection of data relative to municipal indebtedness and taxation has placed in the hands of the central authorities a great mass of comparable statistics which have been invaluable not only to officials and investors but have served as a sound basis for necessary changes in legislation.

(7) The Massachusetts legislation was carried out in a state where the instinct of local self-government is especially deep-rooted and strong. Its enactment involved nothing less than spreading among local officials and taxpayers the genuine conviction that methods tolerated for centuries were unsound and uneconomical and this meant eradicating from the citizenship of 353 communities a deep-seated prejudice against centralization. The fact that this conviction was created and these prejudices largely removed is a real tribute to the vision of those in

charge of the reform and to the practical wisdom of those who embraced it. The success of the program in practice is due very largely to the spirit of co-operation existing between state and local officials and their willingness to consider themselves partners in a problem of general as well as local importance.

The New Jersey Scheme for Local Financing

Projects looking to the reform of local financial practice in New Jersey go back to the appointment in 1906 of a Commission on Municipal Government.[26] The report of the commission, made in 1907, contained recommendations which are the same in principle as those which led to the existing scheme, but it led to no comprehensive legislation. The work of the commission is important for this study, however, in that it marked out the line of approach for the more detailed investigation which took place when the subject again attracted the attention of the legislature.[27]

The statutes constituting the New Jersey scheme for municipal financing were largely the result of the findings of a Commission for the Survey of Municipal Financing, appointed pursuant to a resolution of the House of Assembly of March 2, 1915. The Commission, after holding hearings in different sections of the state and surveying the laws and practices of other states with regard to municipal finances, presented its findings with recommendations to the legislature which assembled in 1916. Two conclusions reached by the Commission stand out as specially prominent.[28]

1. The net indebtedness of New Jersey counties and municipalities had doubled in the ten years preceding the investigation and amounted in 1915 to between $200,000,000 and $225,000,000. Against this sum there were set aside sinking funds amounting

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[26] *Joint Resolution No. 8, N. J. Laws*, 1906.

[27] *Report of the Commission for the Survey of Municipal Financing*, p. 5.

[28] The data collected by the Commission were not published and are not available in printed form. An idea of the condition of local finances and debts may be obtained from the resolution creating the Commission and from the Commission's report. The analysis of the laws given here is based upon a study of the Commission's report, the statutes themselves, the analysis of the laws, written by their author, Senator Arthur N. Pierson, and from conversations and correspondence with those in close touch with the situation.

to approximately $42,000,000.[29] The chief problem dealt with by the Commission was that concerning the methods that had been adopted for the final extinguishment of these debts. The investigation showed that in many places sinking-fund increments were not always raised and in others, if raised, were not properly and legally administered. After calling attention to the facts that a large part of the final accumulation in a sinking fund consists of earnings and that such funds would continue to exist in New Jersey for another forty or fifty years, no matter what was required as to future debt issues, the Commission emphasized the importance of wise administration of such funds and summarized the faults of the existing statutes and practice as follows:

(*a*) The unscientific provisions of the statutes for annual sinking-fund requirements.

(*b*) The lack of proper consideration on the part of public officials for sinking-fund obligations.

(*c*) The lack of properly constituted control and supervision over sinking funds.

(*d*) The inefficiency of the present administration of such funds due to the lack of independence of sinking-fund commissions from local governing bodies.[30]

The recommendations of the Commission on the subject of sinking funds aimed to correct these defects. (*a*) Recognizing the fact that the earning power of investments constantly varies and that truly scientific sinking-fund administration requires that this be taken into account, it was recommended "that the actuarial basis with annual adjustments be adopted as the method of administering sinking funds in the future." (*b*) Investigation having shown that New Jersey sinking funds earned from 3.25 to 4.37 per cent the Commission recommended "that a 3.5 per cent cumulative basis be fixed as the standard for New Jersey sinking funds"; this basis would allow a reasonable factor of safety to assure the amount necessary to amortize bonds and to adjust the variation in valuation of securities

[29] *Report of the Commission for the Survey of Municipal Financing*, p. 7.
[30] *Report of the Commission, etc.*, p. 21.

held by the funds and their earnings on a true basis. (*c*) Experience having shown that many local governments were lax in the administration of sinking funds and that the only audit of such funds was made by the same authority that appointed the trustees, it was recommended "that all sinking funds be placed under the audit and supervision of some state authority; that such authority certify to the governing body the amount to be raised by the annual tax levy as the sinking-fund requirement for the current year, and be vested with power to compel the payment of this requirement to the sinking-fund commission when due." (*d*) "The sinking fund, from one point of view," said the Commission, "is the taxpayers' saving account for the payment of outstanding bonds. It is, in reality, the bondholder's primal security for his bonds. The real trusteeship, therefore, of the sinking-fund commission is for the bondholders. . . . It is held that the best results, both to taxpayers and bondholders, would be obtained by providing that a majority of the commission shall not be connected with the governing body." It was recommended "that the sinking-fund commission for all municipalities and counties be composed of five members at least three of whom shall have no connection with the governing body and be men of financial training and experience."[31] (*e*) The last proposal of the Commission looked to the rehabilitation of sinking funds which, through neglect, were below their proper requirements. To accomplish this purpose the Commission recommended that "an annual tax of not less than 1-5 mill be imposed, until all sinking funds are up to standard requirements." Such a tax would be equivalent to two points on the tax rate and would not impose a serious burden on the community, "but would within a reasonable time, bring all sinking funds up to a proper standard and do away with the continual refunding of bonds which has imposed such a serious handicap upon public finances."[32]

2. The hearings held by the Commission brought out the fact that the conduct of local financial affairs was made unreason-

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[31] *Report of the Commission*, pp. 22–23.
[32] *Report of the Commission, etc.*, p. 23.

ably difficult by (*a*) the complexity of existing statutes, and (*b*) by the vast mass of special legislation and the ease with which laws general in form but specific in their application might be passed. "Many laws," said the Report of the Commission, "which form a part of the present code were drafted solely to give power and facility to accomplish a specific purpose; the law remains, however, after the purpose has been served, often weakening the policy of the general laws. At the present time there are over two thousand statutes governing the financing of county and municipal affairs, a large number of which recite in detail the provisions for creating debt obligations, but fail to direct the method and define the means for their retirement."[33]

The general recommendation of the Commission was that a general law be enacted that would specifically direct the creation and the retirement of public obligations for all classes of municipalities and counties. It was felt that by this means a large part of the apparent necessity for special legislation would be removed. Most of the detailed and specific recommendations of the Commission were directly or indirectly related to these points.

The report of the Commission, together with the drafts of nine statutes covering its principal recommendations, was presented to the legislature of 1916. In order to get the views of local officials as to the desirability of the proposed measures, hearings were held both by the Judiciary Committee of the House, to which they were referred, and by the Governor. At these hearings considerable opposition developed among the city officials represented. The chief counts in the opposition were directed against state supervision of local sinking funds. Such supervision was described by different officials as "uncon-

[33] *Report of the Commission*, p. 5. The condition of the New Jersey statutes on the subject was thus described by Mr. Robert R. Reed, of the firm of Reed, Dougherty and Hoyt, in a paper read before the New Jersey Savings Banks' Association: "No state needs a revision on its bond laws quite so much as New Jersey. It stands alone in the number, variety and complication of laws covering substantially the same subject. There has seemed to be no limit to the facility with which a new general law may be enacted to meet every particular demand. Under these laws there is practically no limit to the total bonded debt which may be incurred by municipalities, and no adequate limit to the number of years bonds may run." Quoted in *Report*, p. 6.

stitutional," "undemocratic," and violative of "home rule."[34] Perhaps half the population of the state was represented at these hearings but it seems quite obvious that in many cases the opposition was made for personal or political reasons.[35] Whatever its intrinsic merits, however, it had sufficient weight with the Governor to cause him to veto eight of the nine bills which had passed the legislature March 22, 1916.[36] The measures vetoed were passed again at the session of 1917 and approved by Governor Edge. Additions were made in 1918.

The New Jersey scheme may be said to be contained in two groups of statutes: (1) Those regulating the creation and extinction of debt by local authorities, with certain tax budgetary measures forming an integral part of the scheme for debt financing, and (2) those providing for central supervision of local financing. The laws will be analyzed in this order.

Permanent Financing

The recommendations of the Commission for the Survey of Municipal Financing, so far as they concerned permanent financing, were enacted into law by Chapter 252 of the Laws of 1916. This act grants to the governing body of all municipalities and counties in the state authority to issue bonds for local improvements or other purposes authorized by law, including temporary indebtedness, but specifically forbids funded debt for current expenses or subsequent refunding of any debt created originally for such purposes. The act was to take effect immediately and superseded, with certain exceptions, all other laws on the subject.[37]

New Jersey has no constitutional debt limit and prior to 1916 no limit was prescribed by statute which could fairly be

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[34] Hearing before the Judiciary Committee, January 31, 1916; see Trenton *Evening Times*, February 1, 1916, p. 14.

[35] Editorial comment in the Trenton *Evening Times* for January 31, 1916, p. 6; February 2, 1916, p. 6; March 21, 1916, p. 6; *per contra*, Newark *Sunday Call*, April 2, 1916, p. 8.

[36] Trenton *Evening Times*, March 23, 1916, p. 4. The act approved was the so-called Pierson Bond Act, Ch. 252, *Laws of 1916;* this act did not contain the objectionable features of the proposed sinking fund act.

[37] Secs. 1, 14, Ch. 252, *Laws of 1916*. The act does not apply to debts for school purposes which are regulated by Ch. 186, *Laws of 1919;* nor to temporary debts secured by taxes in process of collection or in arrears.

called general in its application. The actual limit varied, in the different classes of municipalities, from 8 to 15 per cent of the value of real and personal property in the taxing district, and some subdivisions had no debt limit. It was possible, under existing laws, for indebtedness to equal 22 per cent of the assessed value of property. It was the contention of the Commission for the Survey of Municipal Financing that the average local budget could not safely devote more than 25 per cent of the current revenues to the debt service. The Bond Act embodied the Commission's recommendation of a 7 per cent debt limit based upon the average of the last three years' assessed value of *real estate*.[38]

The sole authority for the issue of bonds under the New Jersey act is the governing body of the municipality.[39] This grant of authority, however, is surrounded by certain safeguards. (*a*) Except in cases where a proposed debt would be wholly exempt from the statutory limit, the law requires, before the passage of the debt ordinance, the filing, by the financial officer of the city, of a Supplemental Debt Statement containing data intended to reveal to the taxpayer the present net debt, the amount of the proposed issue of bonds subject to the debt limit, the average assessed value of the real property for the preceding three years, the percentage of the borrowing power already used, and that available after the incurring of the proposed debt.[40] This statement, besides being filed with the city clerk, must be incorporated in the ordinance authorizing the indebtedness.[41] In addition the governing body must declare in the bond ordinance the probable period of usefulness of the intended improvement, which may not exceed that permitted by the act.

Section 3 of the act provides that the maximum maturity

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[38] Subsection 3, Sec. 12, Ch. 252, *Laws of 1916*. Special assessment debts, water debts and debts for income-producing utilities and for school purposes (distinct from debts for such purposes incurred by the school district) are outside the limit under certain circumstances; see Ch. 234, *Laws of 1921; Analysis of the Laws*, pp. 112–113, 121.

[39] Sec. 9 of the Act, however, provides that in boroughs and townships a petition signed by 10 per cent of the taxpayers may order a special bond election at which a majority of those voting must approve the proposed debt.

[40] Subsection 2, Sec. 12.

[41] Sec. 2.

of bonds shall in no case exceed fifty years, that all bonds shall be issued under the serial payment plan, the first payment to be made not later than two years from the date of the bonds, and that no maturing installment shall be more than 50 per cent in excess of the smallest prior installment. Section 4 provides for the maximum maturity limits of bonds for various purposes. These maturity limits are given in Table XXIII.

TABLE XXIII.—MATURITY LIMITS OF BONDS UNDER NEW JERSEY BOND ACT

PURPOSE OF ISSUE	MATURITY LIMIT
Elimination of grade crossings	50 years
Acquisition of land for parks	50 "
Sewers and sewage disposal	40 "
Acquisition or construction of water supply systems	40 "
Land for other than park or cemetery purposes	40 "
Acquisition of gas plants	30 "
Land for cemeteries	30 "
Playgrounds, with or without buildings and equipment	30 "
Land for streets, elimination of curves, grading, etc	30 "
Fire or police alarm systems	30 "
Stone or concrete bridges or iron superstructures	30 "
Acquisition of electric light or power plants	20 "
Construction of buildings and original equipment—	
If frame construction	20 "
If non-fireproof but not frame	30 "
If fireproof	40 "
Additions to buildings and original equipment—	
If frame construction	15 "
If non-fireproof but not frame	20 "
If fireproof	30 "
Street and road paving—	
Gravel	5 "
Macadam	10 "
Concrete	15 "
Blocks or asphalt	20 "
Incinerators and garbage disposal plants	10 "
Curbs, sidewalks and gutters	10 "
Additional departmental equipment	10 "
Connecting dwellings with public sewers	5 "
All other purposes—not to exceed	40 "

TEMPORARY FINANCING

The Commission for the Survey of Municipal Financing found that during the year 1915, of $52,000,000 raised by taxation, $20,000,000 were anticipated by temporary borrowing.

The burden of interest imposed by such borrowing is obvious and under conditions then existing in New Jersey this practice required special treatment. Prior to 1917 the law allowed borrowing not only in anticipation of taxes to be collected during the current year but also permitted loans to be secured by taxes in arrears. In spite of the fundamental difference in the character of the security in such cases, the law provided but one instrument for such loans and moreover, was not sufficiently specific as to the conditions under which such loans might be made and the time and method of their repayment.[42] The statutes allowed borrowing at percentage limits varying from 50 to 100 per cent of the anticipated taxes. The recommendations of the Commission were incorporated in the Budget Act of 1917.[43]

The Budget Act provides first of all two instruments for temporary borrowing. Loans in anticipation of taxes levied but not yet collected are evidenced by Tax Anticipation Notes. Power to borrow in anticipation of taxes comes to the municipality at the adoption of the annual budget, which must be not later than February 24th, and extends to December 1st. Such loans must not exceed 50 per cent of the amount to be raised by taxes during the current year, after deducting sinking-fund requirements provided in the budget and certain state and county taxes. All Tax Anticipation Notes must be retired by December 31st of the year in which they are issued. No other instrument may legally be used for this purpose.[44] This borrowing is in anticipation of *taxes* only; miscellaneous revenues may not be used as a basis, nor is there any borrowing power against surplus revenue appropriated from the previous year's balance. These notes bear the endorsement of the chief financial officer of the city as to the amount of the city's borrowing power then available and the notes issued against such borrowing power.

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[42] *Report of the Commission*, etc., p. 14.

[43] Ch. 192, *Laws of 1917*, amended by Ch. 242, *Laws of 1918* and Ch. 178, *Laws of 1919;* an analysis of this Act appears in the *Analysis of the Laws Affecting County and Municipal Finances and Taxation*, pp. 18–43.

[44] Sec. 21, Ch. 192, *Laws of 1917; Analysis*, pp. 37–38.

On June 1st and December 1st municipalities come into possession of a new borrowing power, namely, to the amount of taxes due on those dates but unpaid. Borrowing in anticipation of the receipt of such taxes may be done only through the use of Tax Revenue Notes. The maturity of such notes is not limited to one year but they must be finally paid on or before the 31st of December of the fourth year following that in which the taxes against which they are issued became delinquent.[45] In the event that notes are still outstanding at the end of the fourth year, it is made mandatory that the budget for the year include a sum sufficient to retire them. It is the purpose of this section of the Budget Act to write out of the city's borrowing power unpaid taxes of more than three years' standing and thus abolish the common practice of contracting indebtedness on a fictitious basis.

The Budget Act provides that emergencies which could not be foreseen may be met by a two-thirds vote of the governing body by the issue of Emergency Notes or Bonds. Provision must be made for the payment of such notes or bonds, if they are less then ⅓ mill on the assessed valuation, in the budget of the next year; if more than this amount their payment may be spread over several years by paying them off at the rate of ⅓ mill on each year's tax levy.[46]

The provisions of the New Jersey Budget Act concerning temporary indebtedness are mandatory and were intended to place the municipalities of the state on a "pay-as-you-go" basis as soon as possible. While their general purpose does not differ from similar laws in other states, the care for the details of such financing is in striking contrast with the general statements found elsewhere which are obviously not scientifically planned programs but strike the student as little more than pious wishes of an ill-informed legislature.

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[45] Sec. 22, Ch. 242, *Laws of 1918*. Since after June 1st a borrowing power on Tax Anticipation Notes is still existent as well as the power to borrow against delinquent taxes the law provides that the power to borrow on Tax Anticipation Notes shall be exhausted before recourse is had to the use of Tax Revenue Notes. Tax Revenue Notes must also bear certification of the chief financial officer as to the city's borrowing power and notes outstanding against such power.

[46] Sec. 25, Ch. 192, *Laws of 1917*.

Floating Indebtedness

On this class of public debt the Commission for the Survey of Municipal Financing reported: "The survey has revealed that many of the municipalities . . . have not been meeting the full cost of the conduct of their affairs out of the revenues applicable to the current year. There have been employed a multitude of schemes and expedients to conceal such unbusinesslike practices. . . . This has brought to many communities floating debts which have been periodically funded into long-term bonds and the process repeated in some instances by refunding floating debt bonds. . . . Such a policy is too dangerous to be further sanctioned by the statutes."[47] The recommendation of the Commission that such debts be immediately funded was adopted in a law passed in 1917.[48] This act provided that so far as was possible existing floating indebtedness should be converted into Tax Revenue Notes maturing in not more than three years. All indebtedness remaining after such conversion should be refunded by the issuance of Floating Indebtedness Bonds or Notes payable serially and running not more than twenty years. It was provided in addition that a special tax should be included in each annual levy sufficient to meet interest and maturing installments of such bonds. By an amendment to the original act, passed in 1918,[49] it was stipulated that such refinancing should be completed by November 1st of that year after which date floating debts could not be paid except by their inclusion in the annual budget or by the issue of Interest Deficiency Notes.[50]

The Regulation of Sinking Funds

The New Jersey Sinking Fund Act of 1917 carried into effect the recommendations of the Commission for the Survey of Municipal Financing. The main features of this act require comment. It provides first of all that the Sinking Fund Com-

[47] *Report of the Commission*, etc., p. 13.

[48] Ch. 153, *Laws of 1917;* re-enacted, with slight changes, as Ch. 84, *Laws of 1920.*

[49] Ch. 244, *Laws of 1918.*

[50] These notes are provided for by the Budget Act of 1917; if issued prior to February 15th they must be retired on or before December 31st of the same year; if issued after February 15th, they may run until June 15th of the following year. See *Analysis of the Laws*, p. 93.

mission shall be a body distinct from and not directly subject to the legislative branch of the local government, and moreover, that a majority of its members shall be persons not holding any other office under the municipality. The citizen members of the Commission are required by the act to be resident taxpayers and to have "financial qualifications."[51] The Commission is subject, however, in the matter of audit and inspection to the governing body as well as to the State Commissioner of Municipal Accounts.

The act is quite specific as to the details of sinking fund management. Investments of sinking fund moneys is restricted to bonds of the United States and the state of New Jersey and its subdivisions.[52] Direction is also given as to the general manner of setting up and keeping sinking fund accounts and the method to be followed in computing the value of existing funds and the amount of the annual requirement to be carried to each fund. The amortization plan adopted requires that all calculations be made on a 3½ per cent annual cumulative basis.[53] Since the adoption of the new amortization basis made necessary the exact relation of existing sinking funds to the standard requirements, a valuation of the funds as of December 31, 1916, was ordered. Moreover, the Commissioner of Municipal Accounts is vested with authority to order a new valuation at any time.[54]

It is provided further that when the credits of a sinking fund equal the amount of the bonds and the latter are not due, no

[51] The Commission may contain five members and that number is mandatory where the fund exceeds fifty thousand dollars; where it is less than this amount three members are sufficient. The five member Commission consists of the executive and financial officers of the city, *ex officiis*, and three citizen members, appointed by the executive officer. In the three member commission the only *ex-officio* member is the financial officer. The Act defines a serial bond as one the installments of which mature in successive years during three-quarters of the period during which the issue is to run; all others are "term bonds" and hence subject to the provisions of the Act. Secs. 1, 2, Ch. 84, *Laws of 1920*.

[52] Sec. 8, Sec. 4 of the Act specifically requires that when funds are invested in real estate mortgages such investments shall be liquidated as soon as possible and the funds reinvested as provided in Sec. 8.

[53] Funds arising from sources other than taxes are not to be confused with the annual requirements, which are a fixed obligation running to the bonds, which are dependent upon the tax levy alone for their amortization. Assessment money paid into the sinking fund for safekeeping is to be kept separate and credited to the principal and not to the earnings of the assessment bond funds. See *Analysis of the Laws*, p. 82.

[54] Sec. 18.

further contributions to the fund are required and the earnings of such fund may be used (1) to make up deficiencies in other funds, or if no such deficiencies exist (2) they may be used to offset the annual requirements of other funds. In the event that the earnings of a fund exceed 3½ per cent the excess may be used as an offset to the succeeding year's requirements; but where the annual earnings are less than 3½ per cent the deficit must in all cases be made up in the following year's budget.[55] In case any sinking funds after distribution are found to be below their standard requirements the law provides that a special sinking fund be set up and annual contributions made thereto at the rate of not less than 1-5 mill on each dollar of the local valuation until the deficit is made up. Then upon certificate from the Commissioner of Municipal Accounts, the fund is distributed to the several deficient accounts. Contributions to this special sinking fund are mandatory obligations in the budget.[56]

The enforcement of the provisions of the Sinking Fund Act is placed in the hands of the Commissioner of Municipal Accounts. Section 15 of the act makes it the duty of the local Sinking Fund Commissions to forward to the Commissioner by November 1st of each year their calculations of their requirements for the ensuing year.[57] The Commissioner, after checking this calculation against data in his possession, must within thirty days certify the requirements found by him to be necessary. The amount named by the Commissioner constitutes a mandatory requirement and must be included in the local budget for the following year. By an amendment to the original act[58] the Commissioner was authorized to order the County Board of Taxation to include the amount certified by

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[55] Secs. 16, 17.

[56] Secs. 20–22. Such special sinking fund requirements are in addition to the annual requirements as set forth in Section 14 of the Act. The budget may provide for additions to such special funds in excess of the one-fifth mill required, if desired. The unsatisfactory condition of sinking funds prior to the passage of this Act is indicated by the fact that after five years' operation, 150 out of the 250 New Jersey municipalities requiring sinking fund appropriations are still maintaining such funds. *Statement of Mr. J. L. de Vallière, Office of Commissioner of Municipal Accounts*, January, 1923.

[57] In school districts this must be done by December 1st.

[58] Ch. 266, *Laws of 1918*.

him in the tax levy when it is omitted from the local budget or tax ordinance. The Sinking Fund Commission must report to the Commissioner as to the receipt or non-receipt of the amount certified by him on or before January 5th following certification.[59]

The Commissioner of Municipal Accounts

The plans of those interested in municipal financial reform in New Jersey contemplate the building up of an extensive organization for the supervision of the scheme. This work was to be headed by an independent state department under an Auditor of Municipal Accounts. While the details of such a plan have not been incorporated in law a beginning was made in the creation of the post of Commissioner of Municipal Accounts in the Department of the State Treasurer.[60] The powers of this official are almost unique in American experience and require some comment. They may best be discussed under the following heads: (1) The routine auditing of local accounts; (2) general supervision over local budgets and finances; (3) control over local sinking funds and debt retirement.

1. *Auditing of local accounts.* The auditing functions of the Commissioner were apparently intended in the act creating the office to apply only to municipal sinking funds. An audit of such funds was required to be made at least once in every two years and the Commissioner was given power to prescribe and install a uniform system of accounts both for sinking funds and for the general financial transactions of municipalities, as well as to furnish the forms for annual reports and financial statements.[61] In this act no compulsory general audit of local

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[59] These extensive powers of the Commissioner were sustained by the New Jersey Court of Errors and Appeals in *City of Plainfield vs. Commissioner of Municipal Accounts, the Sinking Fund Commission of Plainfield and the Union County Board of Taxation*, in a decision rendered November 6, 1918. The Justice in refusing a writ of certiorari held: (1) That the Sinking Fund Act was remedial in character and applied to bonds already issued as well as to future issues; (2) that the Commissioner of Municipal Accounts was within his rights in classifying bonds of the city, and (3) that the law was not unconstitutional and did not violate any contract with the holders of term bonds. See 98, *N. J. Law, 84.*

[60] Chs. 154, *Laws of 1917*, and 266, *Laws of 1918.*

[61] Secs. 3, 4, Ch. 154, *Laws of 1917;* Secs. 3b-c, Ch. 266, *Laws of 1918.* Ch. 155, *Laws of 1917*, required the filing of an annual financial report with the Commissioner within sixty days of the close of the fiscal year, which by Ch. 238, *Laws of 1918*, is the calendar year.

accounts was contemplated. In the following year, however, an act was passed making mandatory an annual audit in all municipalities having an assessed valuation in excess of three million dollars and a biennial audit in all others. This act further required a copy of the audit together with the recommendation of the auditor in charge to be submitted to the Commissioner of Municipal Accounts and to be twice published in the municipality concerned.[62] An act passed at the same time required that such audits be made only by accountants licensed by the Commissioner.[63]

A striking difference appears here between the Massachusetts and the New Jersey programs. Compulsory audits of local accounts came in Massachusetts more than ten years after the organization to conduct them was set up. During all this interval the initiative was in the hands of the local authorities; the state stood ready to serve but refrained from imposing its will. In New Jersey a mandatory periodic audit, far-reaching in its extent was imposed upon all municipalities within two years of the investigation of the condition of local finances. The New Jersey scheme no doubt has suffered from the suddenness with which this feature was incorporated in it. The comparatively slow development of the accounting function in Massachusetts gave time for the careful building up of a well-equipped and efficient organization, able, with small additions to its force to handle the new work entrusted to it. In New Jersey the work of auditing has, of necessity, been entrusted to accountants who are not connected with the state office except by the rather unsatisfactory ties of an official license. An act of 1918[64] provides that the auditing of local accounts may be done only by a "Registered Municipal Accountant," licensed by the Commissioner of Municipal Accounts and subject to the supervision of the latter. The accountant's license may be revoked by the Commissioner where irregular or incompetent work is discovered. Until its recent amendment this act was admittedly a rather weak feature of the program.

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[62] Ch. 268, *Laws of 1918*.
[63] Ch. 267, *Laws of 1918*.
[64] Ch. 267, *Laws of 1918*, as amended by Ch. 105 ,*Laws of 1921*.

A good deal of local talent was employed and results were not always satisfactory. The Commissioner, however, has not hesitated to impose high requirements for licensing and to cancel the licenses of incompetents. Present plans of the department contemplate a steady increase in the permanent staff of accountants directly under state supervision and such a proposal commends itself over the present unsatisfactory, though doubtless necessary, makeshift.[65]

2. *Supervision over local financial practices.* Extensive supervisory powers are conferred upon the Commissioner of Municipal Accounts by the act creating his department. It is provided that if examination of a municipality's accounts by a registered accountant shows any irregularities, the Commissioner himself may order an investigation, in conducting which he is vested with the usual power to subpœna witnesses and enforce the production of books and papers. His recommendations on the conduct of the municipality's affairs are mandatory upon the governing body whose members are subject to a fine for noncompliance.

The same act further provides that the Commissioner may "inquire into any item of any budget or certification of requirements and may order any item required by law to be raised by taxation . . . which has been omitted . . . to be included in the budget . . . or may inquire into any item in the budget and if wrongly stated . . . he may order same to be corrected and properly stated . . . and all such orders shall constitute a mandatory obligation upon the governing body. . . ."[66] This section gives the Commissioner practically unlimited power over items in the local budget and in practice he has not hesitated to use it. Each local budget is checked in the Commissioner's office as to the following items: appropriations to debt service, deficits

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[65] Since its creation the Department of Municipal Accounts has published but one report —that for the years 1917–1918. By the first audit "startling disclosures" were made "as to the lack of proper records and loose and improper methods of conducting municipal affairs." Deficiencies in local accounts not due to errors and incorrect computations amounted to more than $75,000. See *Report of the Department of Municipal Accounts*, 1918–1919, p. 5.

[66] Section 3 of the Budget Act (Ch. 192, *Laws of 1917*), requires the city clerk to mail a copy of the budget as soon as approved to the Commissioner.

or over-expenditures in any account, amount of surplus revenue appropriated, "miscellaneous" appropriations so-called (for which no statutory authority exists), and all emergency appropriations. Any misstatement of items or failure to include mandatory items is corrected by the Commissioner whose orders must be followed in the Tax Ordinance or Tax Amendment. The Commissioner, therefore, concerns himself not only with those items which under the statutes *must* be included in the budget, but also with all others for which express statutory authority does not exist, even though such expenditures are of purely local interest.[67]

3. *Control over local sinking funds and debt retirement.* The Commissioner of Municipal Accounts, under the New Jersey statutes has little power over the creation of local debts. His advice may be, and indeed is, sought by local officials on local financial problems but under the law he is, so far as this matter is concerned, little more than the chief accounting officer for local affairs. In its bearing on the extinction of local debts, however, this last function is of prime importance. We have seen above that the Commissioner's certification as to sinking fund requirements is mandatory on local legislative bodies and that he is vested with power to compel Sinking Fund Commissions to bring their funds up to statutory requirements. This power extends, of course, to the certification of the annual requirements for maturing installments of serial issues. There can be little doubt but this portion of the scheme has been admirably conceived. Under its operation conservatism in financing local improvements becomes necessary; the burden of creating such improvements becomes inescapable and not to be lightened by the suaveness and chicanery of local politicians. At the same time responsibility for the initiation of public improvements remains with the locality which, however, reaches its decisions with full knowledge that it must pay its full share in direct taxes during the period of its enjoyment of such improvements.

The schemes for municipal financing adopted in Massachusetts

[67] Statement by the Department of Municipal Accounts, January, 1923.

and New Jersey have been chosen for rather detailed discussion not because they represent the only progress in the treatment of the questions involved, but rather because they illustrate two general principles along which future legislation is likely to proceed, and because each illustrates rather clearly a different point of view of the proper relationship which should exist between the state and its political subdivisions.

The general principles underlying the creation of public debt are not greatly different in the two systems. It is evident, however, that a system for the control of any feature of public finance depends for its efficiency upon the machinery set up for its routine enforcement. Legislative supervision in any field of government is based upon the rather naive assumption that a statute will be self-executing—an assumption which seldom squares with the facts. One of the chief differences between the two systems discussed in this chapter lies in the machinery for enforcing their provisions.

Massachusetts has made a beginning in the direction of providing a central supervising authority but his powers scarcely exceed those of a fact-finding agency. Provision has only recently been made for a compulsory audit of local accounts. Certification of town notes by the Director of Accounts, excellent in itself, is at best capable of providing for control of a comparatively small portion of new indebtedness. Sinking funds are left in the hands of locally chosen bodies whose responsibility runs to the governing body. In short, the Massachusetts program throws very largely upon the locality the enforcement of what the legislature has enacted as a sound policy toward public debt. There is implicitly in the law, it is true, a recognition of the superior efficiency of central administrative supervision, but the history of the whole body of legislation leads to the conclusion that those features have been embodied, to the extent that they have, on the theory that the state should go no farther than to provide the mach nery for such supervision until such time as local governments shall, on their own motion, subject themselves to it. At the same time, the fundamental principles of a sound fiscal policy have been written into the law as rapidly as local opinion has made it possible.

A survey of the New Jersey laws reveals an entirely different set of facts. Their chief significance for our purpose lies, not in the general policy of the state toward local indebtedness, but rather in the way in which the state has placed in its own hands the lines of control of that policy. For the distinctive feature of the New Jersey program is its creation of the office of Commissioner of Municipal Accounts. It is hard to set bounds to the legal powers of this official so broad is the discretion which the law has placed in his hands. In one respect only are his powers less than those of the Massachusetts Director of Accounts—he has no power to pass upon the legality or regularity of municipal obligations prior to their issue.[68] In all other respects his powers are far more extensive. Through his power to certify annually the sinking fund requirements in local budgets he exerts a powerful influence in bringing to local communities a realization of the immediate burden of borrowing. His power to inspect local budgets prior to the enactment of the tax ordinance insures the inclusion in that instrument of every amount required by state law, and in fact, permits him to wield considerable influence over appropriations of purely local interest. In large measure his powers in these respects are mandatory and have been upheld by the state's highest court. What is even more striking is that the financial affairs of the subdivisions of the state were subjected to this central control within the short space of three years and in the face of considerable opposition on the part of local authorities. Among the larger and better governed municipalities of the state there seems now little disposition to question the wisdom of the plan and the sympathetic attitude of those now in charge of its enforcement in dealing with the smaller units has done much to secure confidence and disarm criticism.

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[68] By Ch. 156, *Laws of 1917*, the city clerk is required to file with the Commissioner a certified copy of the proceedings relative to each issue of bonds. This, however, is for purpose of record only, and is not intended to give the Commissioner power to negative local issues.

V

A Suggested Policy Toward Local Debts

This study has been essentially a review of certain legal devices for the control of local indebtedness. We have in this chapter to examine two problems: (1) The possibility of handling the problem of public debt by constitutional and statutory methods, and (2) the kind of machinery best suited to enforce the public policy adopted. The answers to both these questions can be given only after an examination of the nature of public borrowing.

Public borrowing differs from private in only one respect—it is conducted by the elected representatives of the people in response to a more or less definite mandate from the electorate. The time of borrowing then, the purposes for which the public credit shall be pledged, and in many cases, other details of the transaction are settled by popular methods and finally put into effect by officials who exercise little real discretion in reaching decisions. Corporate loans, no matter how subject they may be in theory to the decision of a quasi-democratic body of stockholders are, to all intents and purposes, issued on the decision of executive officers, untrammeled by the views of an electorate. With this exception, all the other elements involved in the use of credit are identical in both cases.

The more important of these elements are: (1) The purpose for which borrowing shall be resorted to; (2) the amount to be borrowed; (3) the term for which the debt shall be contracted; (4) the method by which the debt shall be redeemed, and (5) the price which shall be paid for capital.

A brief consideration of these elements compels the conclusion that they are for the most part economic rather than political in their nature. This is equivalent to saying that few of them are stable or capable of uniform treatment. But a constitutional provision or a statute is in its very nature a general rule, an enunciation of broad policies and scarcely capable of dealing effectively with the varied and changing aspects of

a concrete situation. Let us take, for example, the usual provision that indebtedness shall not exceed a given percentage of the assessed value of taxable property. Once we apply this to a myriad of concrete cases of public debt we see its weakness as an instrument of control. The fact that existing debts show such a wide variation in their approach to the legal limit would indicate that there is nothing sacred or mysterious in the lawmaker's choice of a particular percentage figure. One is led by candor to the belief that the real reason for such variations lies in the varying needs and desires of different communities and the willingness of taxpayers to vote burdens upon themselves for the extinction of debts. Viewed in this light the constitutional and statutory limitations are seen to be little more than pious ejaculations against public indebtedness.

The truth of the matter is that there is no taint of original sin about public borrowing. The creation of debt is only a convenient device for dividing the cost of public improvements between the present and the future taxpayers in proportion to the benefit received by each. The attempt to regulate the incurring of debt by the inclusion of a percentage limitation in the constitution or law is wrong in principle. For neither constitutional convention nor legislature can foresee the needs and judge the capabilities of scores of local communities.

Moreover, such solicitude for the conservative use of the public credit leaves on one side other important considerations. The size of public debts is in itself not important if their creation is accompanied by a rigid policy of liquidation and if obligations have not been created to provide facilities which ought in justice to be met out of current revenues. The real objection to the bonds of a city already heavily in debt arises not so much from the size of the debt as from the known fact that large debts are often contracted for purposes properly chargeable to taxes and for such long periods as to indicate the unwillingness of the community to subject itself to rigid taxation. The demonstrated willingness of a community to tax itself is the final security for a public loan and this security is analogous to a record of steady earnings and efficient management in an industrial property. An efficient tax system, vigilant and devoted

officials, and a sound policy toward public improvements cannot be secured by such limitations on the power to borrow. A percentage limitation at best only provides against excessive borrowing. Even if it is not evaded, its effect is merely negative. To the routine administrative problems of debt financiering it supplies no constructive element.

The same general criticisms apply to attempts to control the other elements of the problem by political means. For example, the usual provision requires the retirement of public debt within a specified number of years. The determination of the period for which a debt should run cannot be made with any degree of satisfaction in a constitution or a general statute. When debts should be paid depends primarily upon the purpose for which they were created. An exact correlation between the life of a public improvement and the term of the obligation creating it is a problem admirably suited for administrative decision. The information necessary to make such a correlation seldom exists in the average community and a rule sufficiently explicit to guide local officials can scarcely be hoped for in a statute. The result of an attempt at constitutional or statutory definition of such a principle can at best be only *comparative* safety in municipal bonding; scientific efficiency will necessarily be sacrificed.

The preceding chapters have been an attempt to analyze the policies adopted by our states toward the problem of public debt. It is evident that in most cases the assumption has been tacitly made that the questions involved in public indebtedness are political in nature and hence susceptible of control by political methods. It is not the view of the writer that government is entirely a matter of business. Many questions arise, even in cities, which can be settled, in a democracy, only at the ballot box or in the council chamber. It must be admitted, however, that these questions are comparatively few in number and that by far the greater part of the problem of municipal government resembles the management of any privately owned service corporation. This is especially true of financial affairs. In selling an issue of bonds a city is forced to compete for capital in a way which differs little, if any, from

the same necessity when faced by a commercial enterprise. No personal rights or questions of far-reaching importance are sacrificed by formulating the rules of public financing in conformity with the best commercial practice.

In the past, our state legislatures have shown little disposition to treat the problem from this point of view. Signs are not wanting, however, that so far as legislation is concerned, a change has taken place in recent years. Aside from the legislation discussed in the preceding chapter, several other states have within late years attempted constructive treatment of the problem. North Carolina in 1917 passed a comprehensive Municipal Finance Act embodying most of the principles governing public borrowing which are generally recognized as sound by investment bankers and fiscal students.[1] In the same year the state of New Hampshire, acting as a result of the disclosures of a special investigation by the State Tax Commission, enacted a new Municipal Finance Act. This act prohibited the creation of debt for current expenses made mandatory the use of serial bonds, forbade the issue of "demand" notes and required the immediate retirement of all such notes still outstanding, imposed new debt limits on subordinate corporations with an exterior limit to cover overlapping districts, and required the adoption of a budget system by towns. The State Tax Commission was given authorit to prescribe budget and accounting forms and to conduct an audit of local accounts on its own motion [2]

The next state to attempt scientific treatment of the problem was Ohio. A tax limitation law of 1910 had so restricted local revenues as to cause extremely rapid piling up of debts, many of which were created to pay current expenses. So serious had the situation become in many taxing districts that action

[1] This Act was amended and re-enacted in 1921. It appears as Secs. 2918–2961 of the Consolidated Statutes of North Carolina. Secs. 2922–2931 deal with the budget; Secs. 2932–2935 prescribe the terms upon which temporary loans may be made; and the remainder of the Act relates to permanent financing. The provisions regarding permanent financing follow very closely those contained in the New Jersey Bond Act. No provision is made, however, for state supervision through a special official, nor is central accounting control provided.

[2] Chs. 57 and 129, *Laws of 1917*, amended by Ch. 60, *Laws of 1921*. See also the *Report of a Special Investigation Relative to Municipal Finance and Accounts*, January 1, 1917, pp. 14–24.

was forced in the session of the General Assembly of 1921, through the efforts of various commercial organizations of the state. The so-called Griswold Act passed in that year struck at the chief evils of the situation by prohibiting the incurring of indebtedness for current expenses, making mandatory the use of the serial method of redemption, limiting the term of indebtedness to the life of the improvement and imposing new debt limits. While the tax rate limitations were not removed, a companion measure lifted these for a period of three years to allow local governments to effect a reconstruction in their finances.[3] Although this act has been in operation only slightly more than a year there seems little doubt that its observance will go far to lead Ohio municipalities back to sound methods of financing.

The Louisiana Constitutional Convention of 1921 wrote into the new constitution of that state the most comprehensive series of provisions to be found in any state. These provisions were immediately enforced by laws passed at the special session of the legislature which met at the close of the convention.[4] In the same year the legislature of Wisconsin collected the scattered provisions of its statutes relating to issue of bonds by local governments into a general bond law, which marks a distinct advance over the law as it stood prior to that year.[5]

In addition to progress made in actual legislation, a reading of the messages of the various state governors to the 1923 sessions of the legislatures shows that in many quarters the whole subject of local expenditures is a live issue. In at least eight of these documents direct reference is made to the necessity of an extension of the state's power over various phases of the problem. The Governor of Oregon after referring to the widespread existence of unwise bonding practices among the subdivisions of that state, said:

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[3] The Griswold Act is found in *109 Ohio Laws*, pp. 336–351. An attempt was made, very largely at the instigation of the Ohio Association of Real Estate Boards to have the principles of the Griswold Act written into the constitution at the election of November, 1922, but the proposed amendment was defeated by the voters. See *Bulletin of the National Tax Association*, January, 1923.

[4] Louisiana Constitution of 1921, Secs. XIV, XV; Nos. 46, 70 and 80, *Extra Session, 1921*.

[5] Ch. 576, *Laws of 1921*.

> In fact, on this whole question, I am of the opinion that the state could to advantage exercise some form of supervisory power over the financila affairs of the various taxing units. Municipalities . . . should not be permitted to impair the credit . . . of the state by running riot with excessive bond issues, making no provision for the payment of the same when due. The principle should control that no bonds should be issued for a longer time than the useful life of the improvement for which the bond is created. And sinking funds should be maintained inviolate.[6]

Pleas for reform in local finances were made also by the Governors of Idaho, Indiana, Iowa, Massachusetts, Nebraska, New Jersey and Arkansas. Special commissions to investigate the whole subject of municipal finance have presented reports to the present sessions of the legislatures of Oregon and Massachusetts and a substantial portion of the report of the New York State Special Joint Committee on Taxation and Retrenchment was devoted to a thoroughgoing discussion of the problem.[7] Such facts justify in a measure the belief that the future will witness a more scientific treatment of the whole question at the hands of our state legislatures.

Such a change, however, if it comes will relate only to the policy toward local indebtedness. Efficient *control*, in the opinion of most students of the problem, means *administrative* control. The detailed questions of routine administration are not the questions about which the legislator can wax eloquent; they are, however, the heart of the whole matter. To solve these questions satisfactorily is indeed to enforce policy. Such a solution is not possible by legislative enactment; it is possible if attempted by a system of centralized, routine control over the details of debt financiering.

The logical method of approach to this problem would seem to be that by which correctives may be prescribed for demon-

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[6] *Message of Governor W. M. Pierce to the Legislature of Oregon*, January 8, 1923.

[7] See *Report of the Commission on Municipal Expenditures and Taxation*, Commonwealth of Massachusetts, House Document No. 1240, February, 1923; *Report of the Oregon State Audit Committee to the 32nd Legislative Assembly*, submitted December 30, 1922; the Oregon legislature at the 1923 session had before it a bill creating a state finance commission with power to supervise the issuance of bonds by subdivisions and to prescribe a uniform system of accounting in sinking funds; it was vetoed by the governor because of its interference with "home rule." *Correspondence with Mr. C. M. Bristol of Freeman, Smith and Camp Co.*, Portland, March 22, 1923.

strated evils and machinery suggested for the positive purpose of aiding in the more satisfactory handling of questions of details The outstanding shortcomings of local officials in debt financing would seem to be (1) their willingness to keep citizens in the dark as to the real financial condition of the city, and (2) their downright ineptitude in the management of financial problems. These shortcomings and their natural fruit of growing debts and tax rates and hampered administration suggest their own remedy.

Proposals for new methods of controlling the creation of municipal debts do not rest upon fear of default on the part of our cities. At least, such a danger is not an immediate one. Municipal bonds will probably long continue to rank second only to those of the Federal Government in point of safety. Default in the payment of principal by American cities has been so rare within recent years that from this standpoint their record may be considered practically clear. There is little consolation, however, in such knowledge, if present practices are such as to jeopardize the future. The management of municipal debt under present conditions involves such difficulties that various abuses are almost certain to accompany it. A recent survey conducted by the Institute for Public Service of New York revealed abuses of the following classes in the handling of municipal bonds in thirty cities of the United States:

1. Many bond issues, although approved by conservative bond attorneys, are in fact invalid because of errors—innocent and otherwise—committed in connection with their issue, sale, and the use of proceeds.

2. Many issues can never be paid off if present practices are continued. Instances where bond issues run far beyond the useful life of the asset created by them are all too common. As the report of the Committee on Non-Partisan Facts of the Institute for Public Service has it, "Some time in the future these financial chickens will come home to roost." Accumulation of bonds of this character and of refunding issues representing old floating debts will mean "inevitable demands for increased debt limits, because the needed improvements absolutely must be provided if the community is to survive. . . . Thus present bond holders will, more and more, consciously be in the position of the bank that has loaned large sums to a corporation in financial difficulties and must either loan additional amounts or lose what it has already loaned."

3. Because of the failure to provide and maintain sinking funds, many present issues cannot be paid at maturity and refunding will be necessary. Moreover, the maturities of bonds issued in the past have been so unevenly distributed as to cause exceptionally large amounts to fall due in one year thus necessitating refunding.

4. Many issuing authorities have not shown good faith in handling their municipal issues.

5. Under present conditions most investors in municipal bonds cannot "learn with reasonable ease the essential facts about the soundness of these investments."

After summarizing its findings concerning these abuses the committee states that "not all of history is condensed in the statement that cities almost never default. . . . It is history that the great increase in public debts during the last few years has materially reduced the margin between debt and the collectable limit to which the courts will be willing to subject property."

The concrete proposal of the Committee on Non-Partisan Facts is that a municipal bond service be established by bond buyers, bond bankers and bond issuers. The work of such a service would consist largely in the collection and dissemination among its members and clients of complete information concerning the methods used by municipalities in their financial affairs. Such an organization would be entirely unofficial although the close co-operation of state and local officials is assumed. Such a scheme undoubtedly has large possibilities and so far as it is likely to go deserves the commendation of all serious students of the problem of municipal indebtedness. It seems doubtful, however, if it could ever be extensive enough to secure the benefits which should come from thoroughgoing state supervision. Moreover, the present powers of state officials are in most cases so small that their co-operation would be of little value, no matter how great their good-will. It is the view of the writer that no matter what organization is set up by investors, the governmental machinery in most of our states needs strengthening if the work of such organizations is to be entirely successful.

There should be somewhere in the state government an official

with adequate powers and secure tenure to oversee the important details of municipal borrowing. Such an official should have at least the following duties: Power to conduct periodical and special audits and make recommendations, or if necessary, mandatory orders to the local officials, as to the proper conduct of their affairs; the power to certify the annual requirements on indebtedness account; power to review local proceedings concerning bond issues and to make such revisions concerning the details of the proposed loan as will conduce to the best interests of the city; power to act in conjunction with the state public utilities commission in evaluating utility properties whose purchase is contemplated by the city, and power to certify, finally, as to the legality of all bond issues.

The first requisite of any system of control is ability to get at the facts of a concrete situation. The possession of the actual facts is of primary importance from several points of view. For administrative reasons it is of obvious value as affording a check on the officers subject to inspection. The possession of full and up-to-date information affords a sound basis for legislation. The proper arrangement and systematization of such data would be of immense value to investors and of scarcely less value to taxpayers, if properly presented. The collection of such data should be a matter of routine. No argument needs to be presented as to the value of the annual audit.[8] Wherever it has been required it has more than justified itself through increased efficiency of local government. Publication of the results of such audits should be required as only through such publicity by an impartial official can the people be correctly informed as to the efficiency of their government.

The power to certify the annual requirements on indebtedness account seems justified in view of our experience with the inefficient and corrupt management of sinking funds. Such experience teaches us that only in this way can local officials be compelled to hew to the line which the law draws for them. No cry can reasonably be raised here that such a power vio-

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[8] The extent of state supervision of municipal accounts is discussed by Wylie Kilpatrick "State Supervision of Municipal Accounts," in *National Municipal Review* for May, 1923, Vol. XII, pp. 247–254.

lates "home rule." In the hands of a wise official such a power can be made a powerful instrument for securing co-operation between local citizens and the state in fighting the battle for efficient government.

The power to revise local plans for the incurring of indebtedness raises more difficult questions. We have some familiarity with the fact-finding and auditing functions of state officials. The proposal we make, however, has the fear-impelling quality of novelty. Moreover, it violates, or seems to violate, certain ideas which we are supposed to cherish concerning the proper relationship between the city and the state. The politician and the demagogue are quick to urge that the city has the inalienable right to borrow on whatever terms it wishes. This is, of course, to assert that the question is political. However, practically the only truly political question involved is, "For what shall the community create a debt?" When this matter has been decided by the community the whole matter passes into the field of administration. There are certain circumstances under which even this question would be economic rather than political. On the whole, it would seem best to allow the state supervisory authority to have an absolute veto on local projects. In cases where the finances of the community are in a flourishing condition there would be small reason for the exercise of such a power; where careful husbanding of the borrowing power is necessary because of past excesses, the use of the power could scarcely fail to be salutary in its effect.

Strong reasons exist for giving the central state authority power to evaluate public utility property and to exercise a degree of supervision over the incurring of debt for the acquisition of such properties. There is visible, in recent legislation, a tendency to allow the acquisition of such properties in such a manner as not to create a general municipal obligation. The administration of laws requiring such debts to be secured by a pledge of the revenues of the plant and by its mortgage presents all the problems of debt retirement and in addition the intricate questions of rate-making and service standards. The responsibility of local officials in this case runs not only to the bondholders but to the users of the service as well. The flexibility

in administration required by the detailed nature of this problem can only be secured by a scheme of routine administrative control. In view of the fact that most of our states have well-established utilities commissions it would not be necessary to transfer their functions to a new organ of government. No good reason exists, however, why the authority supervising municipal loans should not co-operate with the utilities commission in handling this problem. Such supervision would include such matters as the authorization of loans, the determination of the provisions of bond issues, the approval of projects for extensions, the evaluation of properties, accounting control and the validation of credit obligations.

Enough has been said earlier in this study to indicate the importance of a plan for validation of local obligations. Existing schemes provide for more or less satisfactory machinery for passing on issues from the standpoint of their conformity to strictly *legal* requirements. None of these schemes provides for the exercise of unbiased judgment as to the wisdom or economic necessity of the proposed indebtedness. The fact that a state authority, with possession of the actual facts of local finances and wide powers of control over local administration, had certified both as to the legality and the essential soundness of local obligations, could not fail to give such securities a higher standing among investors. It would at the same time insure taxpayers that public improvements would be conceived and executed in a spirit of wholesome conservatism and with due regard to equity in the distribution of the tax burden.

The success of this sort of administration elsewhere is no longer to be doubted. Its use in England for more than a generation is too familiar to require explanation here. Still more recently the cities of the Canadian provinces have found administrative supervision their chief safeguard against unwise financing. The provinces of Nova Scotia, Quebec, Ontario, Manitoba, Saskatchewan, Alberta, and British Columbia have all placed one or more phases of the problem under the direct control of a provincial officer. The extent and character of this supervision is illustrated by the following powers which are vested

in the Local Government Board of the province of Saskatchewan:

1. To inquire into the merits of any application of a local authority for permission to raise money by way of debenture or upon the security of stock, and to grant or refuse such permission.
2. To manage the sinking fund of any local authority which desires to intrust the same to the Board for management.
3. To supervise the expenditure of money borrowed.
4. To obtain from any local authority at any time a statement in detail of its assets and liabilities and of its revenues and expenditures for any definite period, or any other statement of its affairs which may be deemed expedient.
5. To grant an extension of time for the repayment of indebtedness incurred by municipalities for the cost of municipal public works.
6. To administer the sale of local debentures and stocks.
7. To take such action as may be necessary in the cases of cities or other municipalities which are in serious financial difficulties likely to lead to default.
8. To approve by-laws making changes in the interest rate on local debentures.

Validation of local debentures is a power belonging to the Minister of Municipal Affairs.[9]

The general policy of the Saskatchewan Local Government is indicated in the following quotation from one of its recent reports:

> In examining the applications from municipal authorities for power to create capital indebtedness, the board in every case has regard to the needs of the community and its ability to pay its debts. For instance, it is not the policy of the board to authorize a village or town to issue debentures to an amount which would nearly exhaust its borrowing powers for some object which is not essential to the municipal welfare of the community, while the necessities, such as fire-fighting equipment, water supply, or similar important needs, are not provided. . . . The Local Government Board

[9] The Act under which the Local Government Board operates in Ch. 8, *Acts of the Legislative, Assembly of 1917* (first session); see also Secs. 309–378, Ch. 86, *Saskatchewan Revised Statutese 1920* (*the City Act*); also reports of the Local Government Board for 1920 and 1921 in Sessional Papers of the Fourth and Fifth Legislative Assemblies.

. . . scrutinizes each proposal not only from the viewpoint of local hopes and aspirations, but in the light of experience gained in respect of growing local authorities both within and beyond the confines of the province. . . . It may be stated that the financial condition of Saskatchewan's local authorities is sound and on a substantial basis. Less than 1 per cent is in difficulty and the troubles of these exceptions came through over-borrowing by debentures in years previous to the organization of the Local Government Board.[10]

Associated with the Board in its work is an Advisory Committee of two members appointed by the two local government associations of the province—the Saskatchewan Association of Rural Municipalities, and the Union of Saskatchewan Municipalities. This feature of the scheme, which is greatly valued by the official members of the Board, might easily be adopted in the United States where Leagues of Municipalities and similar organizations exist in about half the states.[11]

A central administrative authority such as we have outlined would of necessity wield sweeping powers. It would no doubt violate the principle of "home rule" as understood by politicians and others who are in a position to lose prestige or material gain by an extension of the state's authority. Such objections, however, when examined in the light of the history of the "home

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[10] *Sessional Papers of the Fourth Session of the Fourth Legislative Assembly of Saskatchewan (1920)*, pp. 74–75; *ibid.*, First Session of the Fifth Legislative Assembly, pp. 23–25.

[11] The practice in the other Canadian provinces is prescribed in the following statutes: Nova Scotia: all borrowing is by special act of the legislature, but details are governed by the *Municipal Debentures Act*, 1914, which is enforced by the Commissioner of Municipal Sinking Funds; Quebec: general oversight over the issue of debentures is exercised by the Department of Municipal Affairs, which is administered by the Provincial Treasurer, under the title of Minister of Municipal Affairs; the Department was created by *8 Geo. V, Ch. 20* and its powers increased by *8 Geo. V, Chs. 28, 60* and *9 Geo. V, Ch. 59*. Ontario: the controlling act is the *Municipal Act, Ch. 192, Revised Statutes, 1914;* the Ontario Railway and Municipal Board validates local issues but exercises no other powers. Manitoba: *Municipal Act, Ch. 133, Revised Statutes, 1913;* the Municipal Commissioner approves all by-laws authorizing the issue of debentures, *Sec. 11, Ch. 43, Acts of 1918;* Alberta: no general city act; the *Town Act, Ch. 2, Acts of 1911*, administered by the Minister of Municipal Affairs. Saskatchewan: *The City Act, Ch. 16, Acts of 1908*, administered, so far as the issue of debentures is concerned, by the Local Government Board, created by *Ch. 41, Acts of 1913*. British Columbia: money by-laws must receive the approval of the Inspector of Municipalities, an official whose office was created by the *Municipal Act of 1914, Ch. 52, Acts of 1914* and who is appointed by the Lieutenant-Governor-in-Council. Most of the laws cited here are published in pamphlet form. A very full summary of their provisions may be found in "*Canadian Municipal Statistics*" for 1919–1920, published by Messrs. Wood, Gundy & Company, Toronto and New York.

rule" movement, have little real weight. The struggle of our cities for self-determination was in reality an attempt to secure freedom from misgovernment by irresponsible legislators, many of whom were from distant parts of the state. It was a movement primarily for *good government* directed at the time specifically against the protagonists of *misgovernment.* Its sincere adherents proceeded on the theory that municipal home rule, once realized, would place local affairs in the hands of those most intimately acquainted with local conditions and most responsive to local sentiment. No thoughtful supporter of "home rule" claims that it is a specific against misgovernment. At best it is a safeguard against *misgovernment by the state legislature.* By no candid interpretation of the phrase, however, may "home rule" be construed to mean *local misgovernment.* The practically unregulated conduct of local affairs, however, has often meant little else. This sort of home rule we have had in practice under a regime of legislative supervision.

Moreover, the enthusiastic supporters of the "home rule" argument frequently make unwarranted assumptions concerning the nature of government. Logically this argument rests upon the belief that there is a sphere of local government and another sphere within which the larger unit should confine its efforts. Closer examination of the matter reveals, however, that this belief is fallacious. Not only is it impossible to draw such a distinction in law; it is not possible in practice.[12] The varied functions of government are not set apart, as it were, in compartments; each is a part of a general program—the rendering of service to the community. The machinery for rendering this service is a means, not an end. Government "is not a series of different organizations . . . each performing its tasks through independent departments, but . . . a single task to be done through carefully planned and organized machinery, and by means of careful co-operation in nation, state and local area."[13] Such a scheme as that outlined in this chapter offers the opportunity for such co-operation in an important field of government.

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[12] The only conclusion deducible from such an extensive survey of the problem as H. L. MacBain's *Law and Practice of Municipal Home Rule.*

[13] W. F. Dodd, *State Government,* p. 14, 452–453.

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